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RNC NEWS RELEASE

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FOR IMMEDIATE RELEASE
Tuesday, August 14, 1990
RNC90-048

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STATEMENT BY CHARLES BLACK ON BUDGET NEGOTIATIONS

Washington, D.C. -- Since the budget negotiations began 100 days ago, President Bush has come up with all the ideas, gone every extra mile and taken all the heat.

Meanwhile, the Democrats have stalled, blocked, vacationed, passed bloated appropriations bills, and complained.

Last week, President Bush drew a line in the sand to protect America's vital interests around the world. Today, the President drew a line in the sand to protect America's vital economic interests here at home. President Bush's threat to veto every appropriation that's one dime over what he proposed is real -- and it's on target.

President Bush is going the final mile to bring congressional Democrats to the budget negotiationg table and keep America's economy growing. He's demonstrated his personal commitment to solving one of our nation's most urgent problems.

We need a rational, long-term plan to break the budget dealock before the sequestration axe falls on Oct. 15. It's time the Democrats stopped practicing political arson and got serious about the budget talks.

-30-

THE BATTLE OF THE BUDGET

White House Actions		Congressional Infractions
President Bush proposes budget (1/29/90).	JAN	Democrats complain about the President's budget (1/30/90); they propose an unworkable alternative.
President requests a Budget Summit (5/7/90).		Democrat-controlled House passes child-ca[illegible] bill $20 billion over Bush's request (4/5/90).
President enters budget negotiation: no preconditions (5/15/90).	MAY	
		By piling on pork-barrel projects, Congress swells 1990 supplemental appropriations from Bush-requested $2.2 billion to $4.3 billion (5/25/90).
President proposes revised budget with cuts of $50 billion in 1991 (6/20/90).	JUNE	Democrats complain about revised budget.
President goes the extra mile by stressing that everything is on the table in budget negotiations (6/26/90).		Democrat-controlled House votes to increase housing budget 74% over previous year — $4.5 billion above Bush's request (6/28/90).
President urges Congress to pass balanced budget amendment (7/16/90).	JULY	House defeats balanced budget amendment (7/17/90).
The administration details effects of possible $100 billion sequestration; calls on Congress to offer deficit reduction plan (7/16/90).		House votes $13 billion increase in Labor-HHS appropriations bill—$4.4 billion above Bush's request (7/19/90).
Budget negotiators agree to put budget plans on the table. Republicans prepare plan saving $50 billion in first year and $500 billion over 5 years (7/26/90).	AUG	Democrats fail to offer a plan.
The President, fed up with Democratic inaction, announces plan to veto every spending bill that goes beyond his budget request (8/14/90).		House and Senate balk at suggestion to continue budget negotiations during August recess. House recesses having passed 10 appropriations bills totaling more than $13 billion above Bush's budget request (8/3/90).

New fiscal year begins .... October 1, 1990

Gramm-Rudman sequestration scheduled to take effect .... October 15, 1990

POLITICAL ARSONISTS: DEMOCRATS AND THE DEFICIT

President Bush is going to veto every spending bill the Democrats write that comes in one dime over his budget request.

On June 26, President Bush displayed leadership and courage when he put everything on the table in the budget talks.

But instead of working toward a responsible solution, the Democrats have been bloating the budget and stonewalling proposed reforms. After 100 days, the President decided that enough is enough. When it comes to dealing with Democrats, all bets are off.

This memo explains how the Democrats are selling out the economy for a bowlful of soundbites. It has three parts:

I. BOMBS -- Bloated, Overstuffed Money Bills
II. Stonewalling Reform
III. Suggested talking points.

I. B.O.M.B.s – Bloated, Overstuffed Money Bills

The Democrats have been talking trim and voting fat. Ignoring the need to cut the budget, the Democrats have carried on their old tax-and-spend ways.

- **Since President Bush made his June 26 statement, the Democratic-controlled House of Representatives has passed ten appropriation bills that exceed President Bush's budget request by a total of $13 billion.**

- **On May 24 and May 25, the Democratic House and Senate perpetrated budgetary hijacking. President Bush had sought $720 million in emergency funds to help the world's newest democracies, Nicaragua and Panama. The House and Senate waylaid the proposal and stuffed it with new spending. When they were done, the tab came to $4.3 billion, 600 percent more than the President had asked. For "cover," they cut $2 billion from defense, but that still left $2.3 billion in new spending, much of which was pork. The Democrat-controlled House made its intentions clear when it approved amendments to lard the bill:**

  - **To procure a fish farming laboratory in Arkansas.**

  - **To provide $750,000 to transfer a ferryboat to the government of American Samoa.**

- To force HUD Secretary Kemp, under the Community Development Block Grant Program, to fund 37 programs that Kemp believes are unwarranted.

o When some legislators tried to slow down the spending express, Congress ignored them. On July 13, Rep. William Frenzel (R- MN) offered an amendment to the Treasury-Postal appropriations bill to provide for a 6.9 percent across-the-board cut in all discretionary accounts. Frenzel's proposal would only have reduced the bill to last year's level -- but the House rejected it (*CQ Weekly*, 7/21/90).

o On Wednesday, August 1, the House passed a $27.9 billion housing authorization bill. It authorizes a $6 billion increase in spending for fiscal 1991, compared with a $3 billion increase in the Senate version.

II. Stonewalling Reform

The Democrats have had a number of chances to say "yes" to measures that would improve the economy and ensure budgetary discipline. But instead, they have said "no comment" or "no way."

o On July 17, by a vote of 279-158, the House failed to give the necessary two-thirds support to a constitutional amendment to require a balanced budget. Nearly all Republicans (169-5) supported it, but a majority (110-145) of Democrats voted against it.

o On May 9, President Bush launched the budget summit by saying "no preconditions" (*CQ Weekly*, 5/12/90). But when it came to accepting a capital gains cut without an income tax increase, Senator George Mitchell said: "There are certain points beyond which you cannot go" (*CQ Weekly*, 7/14/90).

o Even before the President's June 26 statement, House Majority Leader Richard Gephardt said: "We asked the president to put down a proposal, and he did" (*CQ Weekly*, 6/23/90). But on July 28, *The New York Times* reported: "Senator Jim Sasser, a Tennessee Democrat who heads the Senate Budget Committee, said he felt no obligation to put forward a proposal until the Democrats actually saw the Administration's plan."

o Sasser's House counterpart, Rep. Leon Panetta, said: "We did not pledge that every time the Republicans slit their wrists we would slit ours" (*New York Times*, 8-2-90).

III. Talking Points

- Mario Cuomo summed up the Democrats' attitude: "And if you are going to do the taxes, you have to do them big. You should do them across the board, you do a rate, maybe you do some consumption taxes, too, maybe you do energy. Do them big. As long as you are going to take the hit for taxes, do them big" (*National Journal*, 7/28/90).

- The Democrats have long been the party of tax and tax, spend and spend, elect and elect. Now they are also the party of stonewall and stonewall, blame and blame.

- The Democrats don't want to solve the budget problem, they want to embarrass the President.

- If the Democratic-controlled Congress fails to meet the Gramm-Rudman targets, there would be an automatic, across-the-board cut of up to $100 billion.

- That cut would slice into the drug war, education, student aid, and other legitimate federal programs. And it could undermine people's confidence in the government's ability to keep the expansion on track.

- A few Democrats have applauded the President's courage. That's good. But now is the time for the Democratic leaders to show some courage of their own -- they should persuade their colleagues to do the right thing.

- The President took the heat. Now the Democrats should join him in the kitchen.

- The President is playing poker, not solitaire.
  The President has anted up. It's time for congressional Democrats to do likewise.

- For 36 years, the Democrats have ruled the House of Representatives.
  For 36 years, the Democrats have had the constitutional power of the purse.
  For 36 years, the Democrats have let the deficit grow in fits and starts.
  For 36 years, the Democrats have been a big part of the problem.
  Now it's time they were part of the solution.

- President Bush fulfilled his legal obligation on January 29, when he submitted his executive budget. That's all he was required to do. It would have been politically easy for him to leave it at that and blame Congress for its failure to act.
  But he went an extra mile when he called the budget summit.

He went another extra mile when he presented a revised budget proposal.
He went yet another extra mile when he made his June 26 statement.
So President Bush has gone three extra miles, but to date the congressional Democrats haven't moved an inch.

- The Democrats like to bob and weave. But now it's time they stand and deliver.

- What happens when the Democrats get their way?
  Just look to Massachusetts, where they've taken the state from high tech to low farce.
  Just look to New York, where spending is up and bond ratings are down.
  Just look to New Jersey, where Governor Florio saw tax increases not as a last resort, but as a first resort.

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EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

JUL 18 1990

MEMORANDUM FOR THE CHIEF OF STAFF

THROUGH: DICK DARMAN
BILL DIEFENDERFER

FROM: TOM SCULLY TS

SUBJECT: Pricing of COLA Change

Attached is my staff's rough pricing of the proposed change in COLA computations you requested on Friday. I have spoken with Representative Michel's staff to ensure that this is the proposal he envisioned. Although it could be criticized by economists because "inflation compounds and it is unfair not to compound COLAs", it is actually a good idea that saves considerable amounts in the out years.

Attachment

18 July 1990

COST OF LIVING ADJUSTMENTS IN NON-MEANS-TESTED PROGRAMS CALCULATED BASED ON INITIAL BENEFIT AMOUNT FOR FISCAL YEAR 1991.

	Additional Savings/Fiscal Year (In billions of dollars)					Five-Year Savings
	1991	1992	1993	1994	1995	
CBO	0	.35	1.05	2.06	3.35	6.81
OMB Staff ***	0	.4	1.1	2.2	3.4	7.1

Annual COLA benefit adjustments are currently applied to the total annual benefit a recipient received in the previous year. This proposal would require that the benefit adjustment in non-means tested entitlement programs be applied to a persons initial benefit, not including other COLAs that the individual had received after initial entitlement. For example, an individual originally entitled to a monthly retirement benefit of $400 after two consecutive COLA's of 5%, would receive a benefit of $440 instead of the $441 when the COLAs are compounded. Social Security, Federal military and civilian retirement and disability benefits, Veterans' Compensation, and Railroad Retirement would be the effected programs. Those programs which benefit low-income individuals such as Supplemental Security Income, Veterans' Pensions, and Food Stamps would not be changed. The forecasted COLAs for 1991 to 1995 are shown below, along with the cumulative and additive percentage increases. The cumulative COLA rows show the COLA percentage changes under current law, while the additive increases show the percentage changes based on the initial benefit amounts under this proposal.

	1991	1992	1993	1994	1995
CBO COLA	4.5%	4.4%	4.2%	4.0%	4.0%
cumulative	4.5%	9.1%	13.7%	18.2%	23%
additive	4.5%	8.9%	13.1%	17.1%	21.1%
OMB COLA	4.7%	4.3%	3.9%	3.6%	3.4%
cumulative	4.7%	9.2%	13.5%	17.6%	21.5%
additive	4.7%	9%	12.9%	16.5%	19.9%

Longer term numbers for this proposal can be found on page 2.

** Social Security Only

By rough estimates, Social Security accounts for 60 to 75% of the savings found from this proposal. However, features such as early retirement found in the other affected programs covered under this proposal - Federal military and civilian retirement and disability benefits, Veterans' Compensation, and Railroad Retirement - could cause their savings to increase faster than Social Security over time.

Annual Savings/Fiscal Year
(In billions of dollars)

	1991	1992	1993	1994	1995	1991-95
OMB Staff						
OASDI	0	.4	1.1	2.2	3.4	7.1
Military/Civil/Rail	0	.1	.3	.6	.9	1.8
Total	0	.5	1.4	2.8	4.3	8.9

	1996	1997	1998	1999	2000	1991-2000
OMB Staff						
OASDI	4.6	5.8	6.7	7.8	9.2	41.2
Military/Civil/Rail	1.2	1.5	1.7	2	2.3	10.3
Total	5.8	7.3	8.4	9.8	11.5	51.5

	2001	2002	2003	2004	2005	1991-2005
OMB Staff						
OASDI	10.7	12.2	13.7	15.3	17	110.1
Military/Civil/Rail	2.7	3.1	3.4	3.8	4.3	27.5
Total	13.4	15.3	17.1	19.1	21.3	137.6

	2006	2007	2008	2009	2010	1991-2010
OMB Staff						
OASDI	18.6	20.3	22.1	24	25.8	220.9
Military/Civil/Rail	4.7	5.1	5.5	6	6.5	55.2
Total	23.3	25.4	27.6	30	32.3	276.1

6

STATEMENT OF
MICHAEL J. BOSKIN
CHAIRMAN, PRESIDENT'S COUNCIL OF ECONOMIC ADVISERS
BEFORE THE
JOINT ECONOMIC COMMITTEE

August 2, 1990

The Administration's Economic Outlook

Chairman Hamilton, Vice Chairman Sarbanes, and other distinguished Members of the Committee, it is a pleasure to appear before you to present the Administration's economic outlook, prepared in conjunction with the Mid-Session Review of the budget.

There have been a number of changes in the U.S. economy since I appeared before this Committee in February. The economic expansion continues to set new records for durability, the unemployment rate remains around its 16-year low, and our trade deficit has continued to come down. The United States remains the world's most prosperous nation. Yet, interest rates are higher than we, and many other forecasters, predicted in January, and the pace of economic growth is more sluggish than we would like. To be sure, we face serious policy challenges. But, if we meet these challenges and pursue sensible economic policies, I remain optimistic that the economic expansion can continue and the United States can increase its rate of long-run economic growth. The most important economic challenge is adopting a credible, multiyear, growth-oriented, deficit-reduction package and a monetary policy appropriate to offset any short-term contractionary effects of such deficit reduction.

The Administration's revised economic projections, reported in the Mid-Session Review of the Budget, were developed by the Council of Economic Advisers, the Treasury, and OMB (the Troika). The revised projections incorporate data available until June and were made prior to the recent GNP revisions. The projections reflect our analysis of the views and opinions of many outside economists, both in the public and private sectors.

Economic forecasting is an imprecise science. Unforeseen events -- from unusual weather to foreign political developments -- make forecasting the course of the economy difficult. In our view, the projections embody the best available forecasting methods, informed judgment, and basic economic principles. The projections should be viewed as a "most likely" scenario. The economy may well perform better or worse than projected.

The Current Situation and Near-Term Outlook: 1990-1991

Long-term interest rates rose significantly around the world in the first part of 1990. This jump was not forecast by us or most private forecasters. Anticipation of increased demand for capital in Eastern Europe, particularly from the rapid reunification of Germany, was a significant factor in this jump. A temporary increase in inflation expectations and the financial turbulence in Japan may also have played a role. Partly as a result of higher than anticipated interest rates earlier this year, the U.S. economy has grown more slowly than we had predicted.

For the first half of 1990, real GNP growth averaged 1.5 percent, with modest increases in real consumer spending, residential construction, and business spending on new plant and equipment compared to the fourth quarter of 1989. Real exports grew at an average 8 percent rate in the first half, and continue to be a bright spot for the economy. For the first half of the year, the real net export deficit was at its lowest level since the third quarter of 1983. However, there was a noticeable slowdown in overall job creation and declines in the number of jobs in the goods-producing sector. Real GNP grew a modest 1.2 percent in the second quarter. (This is the advance estimate, which is often revised considerably.) However, consumption growth picked up toward the end of the quarter. Unusual weather and other special factors have made quarterly real growth statistics less representative of underlying economic movements.

Happily, despite slower growth, the unemployment rate has not moved very much in the last 6 months, remaining very near its 16-year low. Jobless rates for individual worker groups have also remained relatively constant since January, at relatively low levels. The rate for women remains at its lowest annual rate since 1969, while the rate for blacks is at a 16-year low.

Historical revisions to the GNP account for 1987, 1988, and 1989 were also recently released by the Department of Commerce. The revisions confirm that 1987 and 1988 were strong growth years. However, growth in 1989 was revised down significantly. Real GNP is now estimated to have grown 1.8 percent in 1989, compared with the previously estimated 2.6 percent, on a fourth-quarter-to-fourth-quarter basis. The major factor in lower GNP growth was a downward revision to consumer spending on services -- particularly medical services -- for which annual survey data were available for the first time. The fourth quarter of 1989 was particularly weak, posting a 0.3 percent annual growth rate.

While the Administration's economic projections were made prior to these revisions and to the advance estimate of second quarter GNP growth, the qualitative picture we had been anticipating since the summer of 1989 -- slower growth in late 1989 and early 1990, picking up in late 1990 and 1991 -- has not been changed.

Inflation

Measured inflation in the first quarter of 1990 was higher than many analysts had projected late last year, but much of the inflation run-up was due to temporary factors. The effects of last December's cold weather were particularly important:

- o Energy prices rose sharply, with domestic crude oil prices climbing nearly $3 per barrel from the end of November 1989 to early January 1990.
- o Consumer food prices rose at an 11.4 percent annual rate in the first quarter.
- o Food and energy price increases combined to help raise the first-quarter inflation rate to 8.5 percent.

In the last 3 months, however, inflation has once again abated:

- o Overall, consumer prices rose at an annual rate of 3.5 percent.
- o Consumer energy prices fell at a 2 percent annual rate.
- o Food prices rose at only a 2.1 percent annual rate.

In summary, the general pattern of inflation during 1990 appears to be very similar to 1989. In the first half of 1989, CPI inflation averaged 5.7 percent at an annual rate, again led by energy and food price increases. At that time we interpreted the first-half increase as a temporary inflation blip, and second half CPI inflation did indeed trail off, to 3.6 percent. In our judgment, the first-quarter 1990 run-up in inflation was another temporary blip, and so we remain optimistic about the outlook for inflation.

The Projections

The Administration's projections -- both short-term and long-term -- are a consistent package with the Administration's economic policy proposals. Hence, they are a conditional forecast. If the policies or their economic equivalent are not implemented, the projections would not be our best judgment of future economic conditions. Most important in this context is the policy goal of credible, multiyear, growth-oriented deficit reduction, with a monetary policy appropriate to offset any short-term contractionary effects of such deficit reduction. In light of first-half developments, we have revised our economic projections for 1990 through 1995 as follows:

(a) Real GNP Growth

The Administration's forecast for the remainder of this year and 1991 projects continued growth of the U.S. economy. Real GNP is projected to grow 2.2 percent in 1990 and 2.9 percent in 1991. (See Table 1) Exports and business spending on new equipment are likely to be the driving forces behind GNP growth. In January we had projected slightly faster growth: 2.6 percent growth for 1990 and 3.3 percent growth for 1991. Higher interest rates maintained through the first half, led us to reduce the projected growth rates. As with our previous projections, growth is expected to rebound during the second half of this year and into 1991.

(b) Unemployment

The slower projected real GNP growth in the near term is likely to result in a slightly higher average unemployment rate in 1991 than had previously been expected. The unemployment rate is projected to average 5.4 percent in 1990, the same as in the January budget submission, but to rise slightly to 5.6 percent in 1991. In January, we projected a 5.3 percent unemployment rate in 1991.

(c) Inflation

Inflation, as measured by the rate of increase in the GNP implicit price deflator, is projected to be 4.5 percent in 1990 and to fall to 4.2 percent in 1991. For consumer prices, measured by the CPI-U, inflation is expected to be 4.8 percent in 1990 and 4.2 percent in 1991. In January, we predicted 4.2 percent inflation measured by the GNP deflator in 1990 and 4.1 percent inflation in 1991.

(d) Interest Rates

The increase in long-term interest rates through May 1990 caused us to raise our projection of the average level of interest rates for 1990, although we still expect interest rates to decline somewhat. Ten-year Treasury notes are projected to average 8.5 percent in 1990 and 7.9 percent 1991. We are projecting that short-term rates on 3-month Treasury bills will average 7.7 percent in 1990 and fall to 6.8 percent in 1991.

Longer Term Outlook: 1992-1995

Labor force growth is expected to slow as the generation following the postwar baby-boom enters the work force. Labor productivity is assumed to grow at its long-run historical trend. These two factors combine to produce an estimated potential GNP growth rate of about 3 percent. GNP growth between 1991 and 1993 is projected to be above 3 percent as the economy moves toward full utilization of its resources. Thereafter, growth is expected to stabilize around potential. Consistent with GNP approaching long-run potential, the unemployment rate is projected to decline to 5.2 percent in 1995.

Significant progress in devising a growth-oriented Federal deficit reduction strategy and steady reductions in the inflation rate will allow interest rates to decline gradually through 1995. A more stable economic environment is likely to wring out some of the uncertainty premium in interest rates.

Comparison to Other Projections

For the next couple of years, the Administration's forecast is about in the middle of private opinion on the major aspects of the macroeconomic outlook. For 1990, on a year-over-year basis, both the CEA and the CBO call for a 2 percent annual rate of growth in real GNP, about the same as the 1.9 percent average of 52 private forecasts compiled by Blue Chip (the Blue Chip "Consensus") in July. For 1991 on a year-over-year basis, at a 2.8 percent rate of growth, the Administration is slightly higher than the CBO and the Blue Chip "Consensus."

On inflation, the Administration, the CBO and the "Consensus" opinions are essentially the same for 1990 and 1991, using year-over-year percentage increases in the GNP deflator. They differ by at most one-tenth percent. On interest rates, the Administration matches the Blue Chip average this year and is about 60 basis points lower than the average Blue Chip forecast for 1991. The CBO interest rate forecast is about the same as the Administration's in both years.

I must emphasize the Blue Chip forecasters generally make policy assumptions that are different from ours. In this sense, the Administration forecast is not strictly comparable to the average Blue Chip forecast.

The Role of Economic Assumptions in the Budget Projections

Expected outlays and revenues depend on many factors including the state of the economy. The Administration's economic assumptions and budget policies are designed as a consistent package. The changes we have made in our economic assumptions account for only a small part of the change in the projected Federal deficit for 1990 and 1991. In fiscal year 1991, the projected deficit is $168.8 billion excluding Resolution Trust Corporation (RTC) spending. This compares with $93.2 billion in the January budget excluding RTC spending.

Of the resulting $75.7 billion change in the projected deficit for fiscal 1991, $49.3 billion is due to technical re-estimates and $24.2 billion is due to changing economic assumptions. Most of the change due to economic assumptions is related to higher than previously expected outlays because we (as well as most private forecasters) now expect higher interest rates than we expected 6 months ago.

Concluding Remarks

Despite the recent sluggishness and the policy challenges we face, my best judgment is that the economy will continue to grow. As I noted earlier, economic forecasting is an imprecise science, though, and economic growth could be more rapid than I have indicated today, or it could be slower.

As I have stated elsewhere, economic expansions do not end on their own; they end as a result of external shocks, economic imbalances, or inappropriate economic policies. The Administration is working hard to ensure that economic growth continues, and that it is not only made more rapid, but also made more secure.

We look forward to continuing to work with the Congress to achieve substantial, growth-oriented deficit reduction, which, combined with a quick and full monetary policy accommodation, will set the stage for a continuation of what is already the longest peacetime expansion on record, further enhancing the long run growth potential of the economy, while controlling inflation.

Table 1

ADMINISTRATION NEAR-TERM OUTLOOK
(Calendar Years)

	1990	1991
	(Percent Change, 4th Quarter to 4th Quarter)	
Real GNP		
Mid-Session Review	2.2	2.9
January Budget	2.6	3.3
GNP Implicit Price Deflator		
Mid-Session Review	4.5	4.2
January Budget	4.2	4.1
CPI-U		
Mid-Session Review	4.8	4.2
January Budget	4.1	4.0
	(Annual Average)	
Unemployment Rate (Total)		
Mid-Session Review	5.4	5.6
January Budget	5.4	5.3
3-Month Treasury Bill Rate		
Mid-Session Review	7.7	6.8
January Budget	6.7	5.4
10-Year Treasury Note Rate		
Mid-Session Review	8.5	7.9
January Budget	7.7	6.8

Table 2

ADMINISTRATION ECONOMIC PROJECTIONS
(Calendar Years)

	Actual 1989	Projections 1990	1991	1992	1993	1994	1995
		(Percent Change, 4th Quarter to 4th Quarter)					
Real GNP	1.8						
Mid-Session Review		2.2	2.9	3.3	3.2	3.1	3.0
January Budget		2.6	3.3	3.2	3.1	3.0	3.0
GNP Implicit Price Deflator	3.7						
Mid-Session Review		4.5	4.2	3.9	3.6	3.3	2.9
January Budget		4.2	4.1	3.8	3.5	3.2	2.9
CPI-U	4.6						
Mid-Session Review		4.8	4.2	3.9	3.6	3.3	2.9
January Budget		4.1	4.0	3.8	3.5	3.2	2.9
		(Annual Average)					
Unemployment Rate (Total)	5.2						
Mid-Session Review		5.4	5.6	5.5	5.4	5.3	5.2
January Budget		5.4	5.3	5.2	5.1	5.0	5.0
3-Month Treasury Bill Rate	8.1						
Mid-Session Review		7.7	6.8	5.8	5.1	4.8	4.4
January Budget		6.7	5.4	5.3	5.0	4.7	4.4
10-Year Treasury Note Rate	8.5						
Mid-Session Review		8.5	7.9	7.0	6.1	5.8	5.4
January Budget		7.7	6.8	6.3	6.0	5.7	5.4

Table 3
COMPARISONS OF ECONOMIC PROJECTIONS
(Calendar Years)

Fourth-Quarter-to-Fourth-Quarter Percentage Change

	1990	1991
Real GNP		
Mid-Session Review (7/90)	2.2	2.9
CBO (6/90)	2.3	2.5
Blue Chip Average (7/90)	1.9	2.4
Blue Chip Top 10 (7/90)	-.-	-.-
Blue Chip Bottom 10 (7/90)	-.-	-.-
GNP Deflator		
Mid-Session Review (7/90)	4.5	4.2
CBO (6/90)	4.3	4.0
Blue Chip Average (7/90)	4.3	4.1
Blue Chip Top 10 (7/90)	-.-	-.-
Blue Chip Bottom 10 (7/90)	-.-	-.-
CPI		
Mid-Session Review (7/90)	4.8	4.2
CBO (6/90)	4.8	4.4
Blue Chip Average (7/90)	5.0	4.4
Blue Chip Top 10 (7/90)	-.-	-.-
Blue Chip Bottom 10 (7/90)	-.-	-.-

Year-Over-Year Changes

	1990	1991
Real GNP		
Mid-Session Review (7/90)	2.0	2.8
CBO (6/90)	2.0	2.5
Blue Chip Average (7/90)	1.9	2.2
Blue Chip Top 10 (7/90)	2.3	2.9
Blue Chip Bottom 10 (7/90)	1.4	1.6
GNP Deflator		
Mid-Session Review (7/90)	4.2	4.2
CBO (6/90)	4.1	4.0
Blue Chip Average (7/90)	4.2	4.0
Blue Chip Top 10 (7/90)	4.5	4.5
Blue Chip Bottom 10 (7/90)	3.9	3.5
CPI		
Mid-Session Review (7/90)	4.8	4.1
CBO (6/90)	4.8	4.2
Blue Chip Average (7/90)	4.8	4.2
Blue Chip Top 10 (7/90)	5.1	4.9
Blue Chip Bottom 10 (7/90)	4.4	3.6

Table 3 (cont'd)
COMPARISONS OF ECONOMIC PROJECTIONS
(Calendar Years)

	Annual Averages	
	1990	1991
Unemployment Rate (Total)		
Mid-Session Review (7/90)	5.4	5.6
CBO (6/90)	5.3	5.4
Blue Chip Average[1] (7/90)	5.3	5.4
Blue Chip Top 10[1] (7/90)	5.5	5.8
Blue Chip Bottom 10[1] (7/90)	5.2	5.0
3-Month Treasury Bill Rate		
Mid-Session Review (7/90)	7.7	6.8
CBO (6/90)	7.6	6.9
Blue Chip Average (7/90)	7.7	7.4
Blue Chip Top 10 (7/90)	7.9	8.1
Blue Chip Bottom 10 (7/90)	7.4	6.8
Long-Term Interest Rates		
Mid-Session Review[2] (7/90)	8.5	7.9
CBO[2] (6/90)	8.5	7.8
Blue Chip Average[3] (7/90)	9.2	9.0
Blue Chip Top 10[3] (7/90)	9.5	9.7
Blue Chip Bottom 10[3] (7/90)	9.0	8.4

[1] Blue Chip total unemployment rate, which is the published Blue Chip civilian rate less 0.1 percentage point.

[2] 10-Year Treasury Bond Rate

[3] Corporate Aaa Bond Rate

162416
Reading

NCF
NATIONAL CHAMBER FOUNDATION

Richard W. Rahn
Executive Vice President

THE CHIEF of STAFF
has seen

July 27, 1990

The Honorable John Sununu
Chief of Staff
The White House
Washington, DC 20500

RE: Budget Summit

Dear Governor Sununu:

On June 29, 1990 President Bush proclaimed that changing economic circumstances require the consideration of tax revenue increases to reduce the deficit. The administration now believes that new taxes will promote economic growth and job creation. As explained in our most recent study entitled "Excise Taxes in the American Fiscal System," a copy of which is enclosed, increased tax revenue does not result in fiscal restraint - indeed new tax revenue only serves to increases the deficit.

As you know, history shows us that tax increases have the perverse effect of increasing the deficit, not cutting it. Between 1947 and 1988 every new tax dollar raised by the Congress has produced $1.72 in new federal spending - or seventy-two cents of additional deficit for every dollar in new taxes. We also know that Federal revenue collections are at an all time post-war high of 19.2% of Gross National Product. Thus, it can be argued that the problem is spending and not taxes.

Research shows that sumptuary taxes neither reduce unpopular activity, such as smoking, nor do they raise revenue in the predicted amounts. The revenue shortfall comes about because government estimators steadfastly refuse to examine the "downstream" affects of higher taxes. Also, we know that higher taxes on commodities, such as alcohol and tobacco, only reduce the consumption of other products - thus cutting into profits and employment across a broad range of economic activity. One researcher has found that the welfare loss associated with increased excise taxation can equal up to one-half the revenue gain to government from such taxes. Thus an excise tax that raises $1 billion in revenues may actually lose $500 million elsewhere. From a policy perspective this is particularly worrisome given that excise taxes are regressive - that is they are levied without regard to one's ability to pay and as such are known to hit hardest the working poor, the middle class, working women, the elderly and others on a fixed income. In a word, these taxes are manifestly unfair.

As your negotiations mature, we are hopeful that you will not seek to adopt the fiscal equivalent of the hubble telescope - an expensive plan that can not meet its objectives. This report finds unambiguous evidence that the Nation would be better served by spending restraint as opposed to new taxes.

Sincerely,

Rahn

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The National Chamber Foundation

EXCISE TAXES IN THE AMERICAN FISCAL SYSTEM

By: Richard Vedder
Lowell Gallaway

POLICY ANALYSIS

THE NATIONAL CHAMBER FOUNDATION

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Foundation studies are prepared both by its staff and by nationally respected scholars from top universities and research groups. For its major programs, NCF assembles a distinguished advisory committee of private sector issue experts, corporate leaders and representatives from the academic community, who work actively with the project researchers. As a result, NCF studies reflect a unique blend of scholarship and practical experience. Only NCF among nationally recognized policy research organizations provides an effective mechanism for applying business expertise to national economic issues in a research environment.

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The essence of Foundation projects is to provide needed analysis on important issues, to outline policy options, and to devise a plan to see that these options are translated into action.

****

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EXCISE TAXES IN THE AMERICAN FISCAL SYSTEM

Excise taxes, or levies on specific commodities, have existed since the beginning of the American Republic. For the bulk of the American experience, they have been the major source of revenue for the Federal Government. This was true as late as 1940 when excise taxes amounted to $1,977 million out of total Federal receipts of $6,548 million. However, since then, excise taxes have become relatively less important as an overall revenue source. The official estimate for fiscal year 1990 indicates that excise taxes will be the least important of the major classes of revenue, accounting for slightly more than $36 billion of total Federal Government receipts of more than a trillion dollars (see table 1 page 3).

The long term decline in the relative importance of excise taxes is easily explainable. Since 1940, individual income tax collections at the Federal level have risen more than five hundred-fold, from less than a billion dollars to a fiscal 1990 estimate of nearly a half trillion dollars. Similarly, the payroll taxes associated with the Social Security system have escalated by more than two hundred-fold and corporate income tax revenues have increased by a factor of about one hundred. Compared to these increases, the twenty-fold rise in Federal excise taxes seems small.

That interpretation, however, is somewhat misleading. In real terms (allowing for inflation), excise revenues more than doubled from 1940 to 1989, with much of the increase coming in the 1980's. The declining relative importance of excise tax revenues reflects more an explosive growth in non-excise tax revenues rather than a shrinkage in the absolute importance of this revenue source. It is interesting to reflect on why the government did not rely on excise taxes to finance the huge increase in government spending in World War II and afterwards. Presumably, the reasons relate to fundamental problems with excise taxes discussed below: their regression and their negative impact on consumer and producer welfare. Again, see Table 1 (page 3) for detailed statistics for the period 1940 through 1990.

Given these historical trends, some might argue that excise taxes have ceased to be a major consideration in debates over tax policy. However, such a conclusion is inappropriate. Over the last decade there have been very important changes in the role of excise taxes in discussions of what is an appropriate set of tax policies for the Federal government. These changes have led to excise levies assuming an increasingly important function in the formulation of tax policy.

Two dimensions of recent developments with respect to excise taxes are quite significant. First, since 1982 the short run pattern of growth in excise tax collections has run contrary to the previously described long run trends. In fact, over the past eight years, in percentage terms, excise tax revenues have increased more rapidly than the two largest sources of revenue —individual income taxes and social security taxes. The second important change in patterns of excise tax collections is a marked shift in composition. There are basically two types of excises, one denoted as "Federal Funds" and the other as "Trust Funds." The Federal funds component consists of the more

Table 1

Sources of Federal Government Revenue, United States, Selected Years, 1940-1990

(millions of dollars)

Year	Excise Tax	Individual Income Tax	Corporate Income Tax	Social Security Taxes	Other	Total
1940	$ 1,977	$ 892	$ 1,197	$ 1,785	$ 698	$ 6,548
1945	6,265	18,372	15,998	3,451	1,083	45,159
1950	7,550	15,755	10,449	4,338	1,351	39,443
1955	9,131	28,747	17,861	7,862	1,850	65,451
1960	11,676	40,715	21,494	14,683	3,923	92,492
1965	14,570	48,792	25,461	22,242	5,753	116,817
1970	15,705	90,412	32,289	44,362	9,499	192,807
1975	16,551	122,386	40,621	84,534	4,998	279,090
1979	18,745	217,841	65,677	138,939	2,101	463,302
1980	17,395*	244,069	64,600	157,803	26,311	517,112
1981	17,587*	285,917	61,137	182,720	28,659	599,272
1982	17,904*	297,744	49,207	201,498	33,006	617,766
1983	23,165*	288,938	37,022	208,994	30,309	600,562
1984	28,455*	298,415	56,893	239,376	34,412	666,457
1985	29,644*	334,531	61,331	265,163	37,040	734,057
1986	30,668*	348,959	63,143	283,901	40,168	769,091
1987	32,457	392,557	83,926	303,318	41,884	854,143
1988	35,277	401,181	94,508	334,335	43,702	908,954
1989	34,084	445,690	103,583	359,416	47,918	990,961
1990#	36,154	489,444	112,030	385,362	50,461	1,073,451

* Excludes windfall profits tax on oil. # Values for 1990 are estimates.
Source: Budget of the United States Government, Fiscal Year 1991 (Washington, DC: Government Printing Office, 1990), Table 2.1, p. A-285).

Table 2

Composition of Excise Taxes, United States, Selected Years, 1940-1990

(millions of dollars)

	Federal Funds			Trust Funds		
Year	Total	Alcohol	Tobacco	Totals	Highway Excise	Total Taxes
1940	$ 1,977	$ 623	$ 706	$ —	$ —	$ 1,977
1945	6,265	2,275	929	—	—	6,265
1950	7,550	2,180	1,326	—	—	7,550
1955	9,131	2,689	1,568	—	—	9,131
1960	9,137	3,127	1,927	2,539	2,539	11,676
1965	10,911	3,689	2,142	3,659	3,659	14,570
1970	10,352	4,646	2,093	5,354	5,354	15,706
1975	9,400	5,238	2,312	7,150	6,188	16,550
1979	9,808	5,531	2,492	8,937	7,189	18,745
1980	8,629*	5,601	2,443	8,766	6,620	7,395*
1981	10,876*	5,606	2,581	6,711	6,305	17,587*
1982	10,263*	5,382	2,537	7,642	6,744	17,905*
1983	11,951*	5,557	4,136	11,215	8,297	23,166*
1984	13,373*	5,315	4,660	14,881	11,743	28,254*
1985	12,749*	5,562	4,779	16,893	13,015	29,642*
1986	13,802*	5,828	4,589	16,866	13,363	29,668*
1987	14,844	5,971	4,763	17,613	13,032	32,457
1988	16,205	5,709	4,616	19,041	14,114	35,246

* Does not include windfall profits tax on oil. # Values for 1990 are estimates.
Source: Budget of the United States Government, Fiscal Year 1991 (Washington, DC: Government Printing Office, 1990), Table 2.4, pp. A-288-90.

traditional forms of excise taxes, the bulk of which have been the so-called "sin" taxes, levies on alcohol and tobacco and to a lesser extent, taxes on "luxury" goods. Federal revenues from these sources have not grown nearly as rapidly as the total volume of excise tax collections. Rather, the major source of growth in excise taxes has been in the Trust Fund component. In the early post-World War II period there were no Trust Funds. Now (fiscal year 1990), there are eleven, designed to deal with such public policy concerns as highways, airports and airways, black lung disease, inland waterways, hazardous substances, ozone depletion, aquatic resources, oil spills, underground storage tank leaks, compensation for victims of vaccine side-effects and something called post-closure liabilities. Eight of these were added during the 1980s. Collectively, revenues for these eleven excise trust funds account for about sixty percent of all excise tax revenues. The changing composition of excise taxes is indicated in Table 2 (page 3).

The shifting emphasis toward the trust fund form of excise taxation raises the question of whether these are not simply "user fees," i. e., charges levied against the recipients of various government services to finance the production of those activities. Are these simply taxes "earmarked" for special purposes rather than general revenue? That is not an easy question to answer. Ultimately, all Federal receipts become intermingled and the availability of revenue flowing into a Trust Fund may have little relationship with the level of expenditures on the designated activity. This can be seen quite clearly in the case of the Highway Trust Fund. In recent years, outlays on highways have been less than highway trust fund receipts on a systematic basis.[1] This is not an isolated case. As of 1989, trust funds other than those of a retirement or medical insurance form held balances of approximately $120 billion.[2] This suggests that revenues from these "special" taxes are more appropriately viewed as additions to the general pool of Federal receipts. We choose to treat them as such.

The changing nature of excise taxation in recent years—its rapid growth and the degree to which new forms of excises have been invented—means that they have become a significant element in the succession of debates about tax policy that have occurred in recent years. This will be quite evident as the so-called "budget summit" discussions between the Congress and the Bush Administration, that are now underway, proceed.

In fact, on June 29, 1990, President Bush solemnly proclaimed that changing economic circumstances require the consideration of tax revenue increases to reduce the deficit. The Administration now believes that new taxes will promote economic growth and job creation. The histroy of tax increases, however, tells us that this view is flatly wrong.

First, the problem is not federal revenue, which as a percentage of Gross National Product (GNP) is at or near an all time post-war high. Federal tax receipts in 1990 are being estimated at 19.2 percent of GNP and for 1991 at 19.5 percent of GNP. Second, new taxes have the perverse effect of increasing the deficit. Between 1947 and 1988 every new tax dollar produced $1.72 in new federal spending—or seventy-two cents of additional deficit for every dollar in new taxes. Third, the automatic sequestration feature of the Gramm-Rudman-Hollings (GRH) deficit reduction plan could produce meaningful and dramatic cuts if it were allowed to operate. In each of the last two fiscal years, Congress has allowed a sequester to be enacted and has used some of the resulting savings to meet the deficit reduction targets. It should be noted that the GRH sequester mechanism is suspended if real economic growth in any two consecutive quarters is less than 1 percent.[3]

Undeniably, as a deficit reduction tool GRH has its limits. Equally certain is that it works and tax increases do not. Nonetheless, Congressional decision makers, with the help of the President, are rushing to enact new taxes. One example of the array of possible kinds of tax increases is provided by Congressman Dan Rostenkowski (D-IL), Chairman of the House Ways and Means Committee.[4] His plan, which he calls the "Rostenkowski Challenge", calls for the following:

1. a one year freeze on tax indexing changes;
2. elimination of the "bubble" so that the top marginal individual income tax rate does not drop back to 28 percent once it hits the 33 percent level;
3. a 15 cent per gallon increase in the gasoline tax;
4. increased cigarette, beer and wine taxes;
5. new taxes on pollutants.

This is an imposing array of revenue measures, a mix of income tax tinkering and an increase in indirect business and consumer taxes of the excise variety. There seems to be a consensus that, especially in an election year, the participants in the political process will develop a strong aversion to altering the structure of the income tax. Indeed, if there is to be a rise in taxes, conventional wisdom suggests that our elected representatives, out of concern for their own political safety, probably will be driven toward supporting increases in more indirect type taxes, such as excises. As one student of the Washington scene, James R. Jones, former Chairman of the House Budget Committee, remarked last year:

> *If a new consumption tax cannot be passed, then the next most likely source of revenue will be an increase in existing excise taxes. The two most prominent are an energy-related tax, such as the existing gasoline tax or the so-called 'sin taxes' on alcohol and tobacco products.*

A good question is "<u>why</u> are excise taxes more likely to win approval than other options?" While several factors may be at work here, it is our contention that excise taxes allow politicians to exploit the principle of "rational ignorance" more than alternative possibilities. Put differently, the political damage per dollar of tax may be less.

A proposal to raise one of the major taxes, such as the individual income tax, Social Security tax or corporate income tax, would receive enormous press coverage and would impact on virtually every citizen in a way that they would know about, given newspaper and television publicity and our system of tax withholding. By contrast, a proposal to raise the same amount of revenue by increasing (or instituting) perhaps 25 excise taxes, each by relatively small amounts, would likely receive far less press coverage. The national news shows probably would not even give time to, say, a proposed new six dollar airport departure tax, but would certainly cover a proposed increase in income tax rates. Indeed, since the airport tax would be simply added to the price of airplane tickets, the traveling taxpayer would likely be unaware of its existence. Indeed, the case can be made that certain tax increases—on alchol, tobacco, coal and certain chemical products—can be a net political plus if sold as a deterrent to drinking, smoking and acid rain, etc. As will be shown, herein, the merits of that case are specious at least.

Therefore, if Congressman Rostenkowski's suggestions for modifying the income tax and introducing new taxes on pollutants do not pass muster, it may be anticipated that the emphasis will turn to the old standbys, excise taxes on a variety of goods, including gasoline, alcohol, and tobacco. One need only turn to the recent history of tax legislation in the United States to see this process at work. In 1982, following the enactment of the income tax reductions of 1981, a deficit-reduction bill—the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA)—was passed. It was designed to raise an additional $98.3 billion in Federal government revenue over a three year period, using a mix of measures that included increases in excise taxes on cigarettes, telephones, air fares, and fuel for private aircraft.[5]

This scenario was repeated in 1984 in the form of the Deficit Reduction Act of 1984 (DEFRA). Although the magnitude of the 1984 tax increases was less than that of 1982, once more there was an excise tax component in the form of higher levies on liquor and a retention of the telephone tax, which had been scheduled to expire.[6]

ARE EXCISE TAXES FAIR?

No tax is a good tax. By definition, a tax is a barrier—a hurdle which needs to be met. Quite reasonably, people seek to minimize the tax bite by foregoing consumption of the highly taxed good or service, or foregoing consumpiton of other goods and services in order to continue to afford the desired ones. Only in the uppermost of brackets, which represent only a small fraction of all households, does price become less relevant. As we move down the income ladder the tax issue becomes more relevant with the greatest impact on the middle class, working women, the working poor, those on a fixed income and the elderly.

The likelihood of increases in excise taxes being included in any deficit-reduction agreement raises interesting difficulties from the standpoint of public policy. Of all forms of taxation, excises are among the least popular with serious students of public finance.[7] They pose five potentially major types of questions that need further exploration:

1. Are excise taxes fair? What is the burden of distribution of such taxes—are they regressive, proportional or progressive in nature?

2. Are excise taxes economically efficient in the narrow but important sense of resource allocation and impact on the welfare of consumers and producers?

3. What is the impact of excises on economic efficiency in an economy-wide sense? Do they promote or harm economic growth?

4. Would enactment of new excise taxes be effective in reducing the size of the federal budget deficit?

5. Are excise taxes justifiable on any other accepted criteria for evaluating taxes?

Taxes that may be considered only mildly harmful on the grounds of efficiency or economic neutrality may well still be considered very "bad" because they are perceived as unfair. Head taxes (lump sum taxes on all citizens) do not have the same negative incentive effects of many other forms of taxes, but they are widely condemned and seldom used because it is generally acknowledged they violate a common sense of equity.

What about excise taxes? Generally, they are considered by scholars in public finance to be undesirable taxes on equity grounds. Before discussing why this is the case, it should be stated that "fairness" and "equity" are somewhat subjective concepts. What is "fair" to one person may be considered "unfair" to another. For example, some people believe it is fair for the government to levy high fees for use of the national parks, citing the benefit principle of public finance that suggests that the cost of governmental services should be borne largely by those persons using the services. Others, however, would consider such high fees as "unfair."

According to the widely accepted "ability to pay" principle of public finance, the burden of financing governmental services should vary with one's financial condition. Under a set of plausible but unprovable assumptions, the nation's overall well-being may be improved by imposing larger tax burdens on the rich than the poor. Specifically, if one accepts the view that a dollar's additional income brings more satisfaction to lower income persons than to millionaires and billionaires, then community satisfaction is enhanced by taxing the rich more proportionally than the poor, since wealthy individuals will give up less satisfaction per dollar of tax than lower income ones.

A progressive tax is one that absorbs a larger proportion of the income of upper income individuals than lower income ones and is consistent with the "diminishing marginal utility of income" assumption outlined above. Our most important federal tax, the individual income tax, has been made progressive because of general sentiment that such progression is fair and desirable. Progressive taxes promote "vertical equity"—differential treatment of groups with varying degrees of economic well being. Many view that as desirable in building a happier and more harmonious society.

Even those individuals that reject the ability to pay principle based on diminishing marginal utility of income usually argue that taxes should be proportional—taxes should be the same percent of income for individuals in all income classes. Fairness to these individuals means that everyone is equally treated, which translates into a equal proportion of income taxed. Virtually no one, however, accepts the proposition that taxes should be regressive—taxing the poor proportionally more than the affluent.

Yet American excise taxes are presently viciously regressive. The three most important excise taxes, tobacco, alcohol and gasoline, burden lower income Americans far more than upper income ones. This is demonstrated by the Consumer Expenditure Survey of the US Department of Labor, a household survey measuring the spending habits of Americans.[8]

Table 3 shows expenditures on three consumer products subject to excise taxation: tobacco, alcohol and gasoline, for three different income groups. Note that as income rises, average

Table 3

Consumer Expenditures on Items Subject to Excise Tax: by Income Classes, United States, 1987

Income Class	Tobacco	Alcohol	Gasoline	% Income Spent
$5,000-9,999	$179	$118	$416	9.71%
$20,000-29,999	265	350	820	5.85
Over $50,000	260	644	1,422	3.03

*Includes motor oil.
Source: US Department of Labor, 1987 Consumer Expenditure Survey

expenditures for the three products rise as well, but they rise less proportionally to the increase in income. Less affluent Americans spend a significantly larger proportion of their income on these taxed items than do more prosperous Americans. Using an earlier version of the Consumer Expenditure Survey, the late Joseph Pechman of the Brookings Institution estimated that federal excise taxes took 13 times as large of a proportion of the income of the poorest five percent of households compared with the richest five percent (Table 4). The proportion of income paid in tax declines consistently as income rises, a sign of a regressive tax.

It is this regression that has led authorities in public finance to reject excise taxation. Consider, for example, Richard Musgrave's critique:

> *Considerations of horizontal equity and efficiency both suggest that a general sales tax is to be preferred to a set of selective excises with differential rates.*[9]

To Musgrave, excise taxes are not only unfair on vertical equity (regression) grounds, but also because of horizontal equity concerns. In other words, two different persons with similar incomes and economic circumstances can pay widely varying excise taxes. If one individual does not drive a car or drink, he is taxed far less than another individual who enjoys alcoholic beverages and also drives a car. Pechman goes further, saying:

> *The case for selective excise taxes is weak....excise taxes rank low in terms of equity on a number of grounds.*[10]

Charles McLure and Wayne Thirsk combine both economic and equity arguments in opposing so-called "sin" taxes:

> *Sumptuary taxes fail to achieve their commonly stated ends–discouragement of consumption of potentially harmful products–and render attainment of the equity goals of society more difficult.*[11]

Two key factors in determining the impact of excise taxes on various income groups are what economists call "price elasticity" and "income elasticity." The concepts refer to the sensitivity of consumers of the taxed product to changes in price or income respectively.

Table 4

Effective Federal Excise Taxes as Percent of Income, 1985

Household Income Percentile	Combined Federal Excise Taxes
0-5	5.2%
15-20	1.4
30-35	1.2
45-50	1.0
60-65	0.8
75-80	0.7
90-95	0.5
95-100	0.4
All classes (including those not listed):	0.8

Source: Joseph Pechman, Federal Tax Policy (Washington, DC: Brookings Institution, 1987), p. 200.

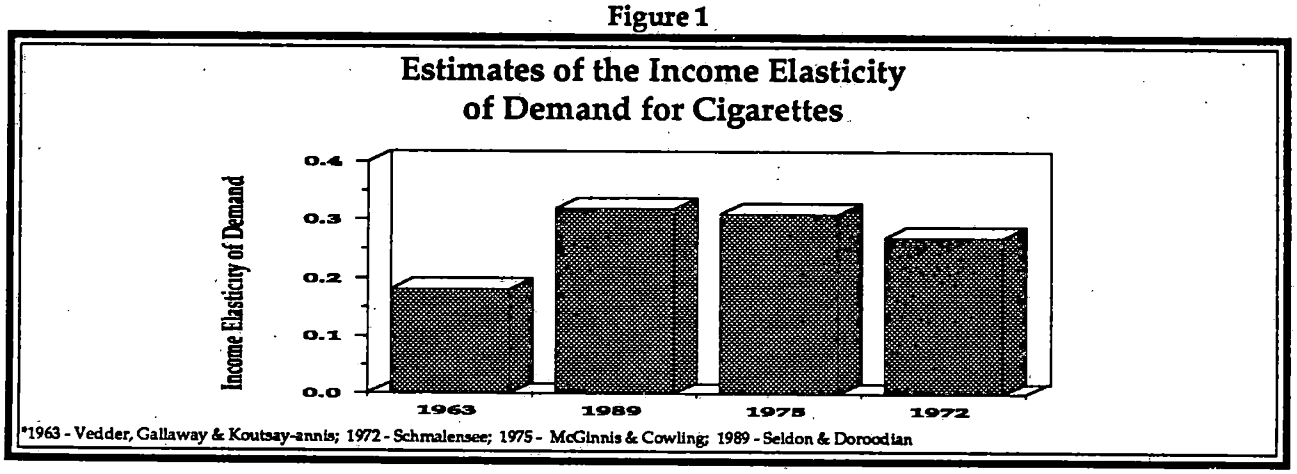
If the price elasticity of demand is high, that means people are sensitive to price. Price increases are met with consumer resistance, and many would-be buyers of the product switch to substitutes. Where price elasticity is high (greater than 1.0), it is difficult for suppliers to pass excise taxes on to the consumer in the form of higher prices, in the short run. In the longer run, there is little doubt that taxes are ultimately shifted to the consumer. Where demand is inelastic with respect to price (less than 1.0, meaning the percent change in quantity demanded is less than the percent change in price), producers can pass on most of an increase in excise taxes to consumers quickly[12]

With but one exception, the authors know of no studies estimating the price elasticity of demand for tobacco to be as great as 1.0 percent.[13] That study was for Great Britain. Recent studies for the United States have estimated the elasticity to be very low, .20 to .40 percent.[14] Using the .40 percent estimate as representative, it is estimated that a 10 percent increase in cigarette prices reduces the quantity of cigarettes demanded by only 4 percent. Early studies had slightly higher estimates, but still below .60 percent.[15]

The empirical evidence, then, supports the view that consumers of cigarettes quickly begin to feel the burden of an excise tax increase. In a competitive environment, ultimately consumers absorb all the burden of a tax, as failure to shift the burden would reduce rates of return on tobacco investment and encourage exit from the industry.

Income elasticity determines the regression of a cigarette excise tax. If a 10 percent rise in income levels is associated with less than a 10 percent increase in the demand for cigarettes, we say demand is "income inelastic", meaning a numerical value of less than 1.0 percent. An inelastic demand means that cigarette consumption rises less rapidly than income. Table 3 (page 8) has already demonstrated the inelastic nature of cigarette demand. As Figure 1 shows, other studies (including one we did using Consumer Expenditure Survey data) indicate that the

Figure 1



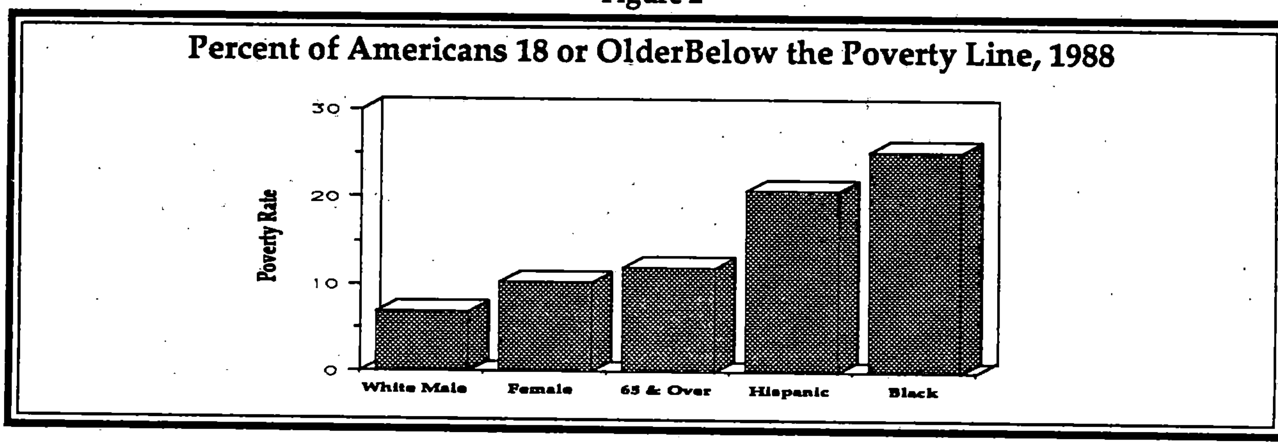
income elasticity of demand for cigarettes is dramatically below 1.0 Percent.[16] Rich people spend only slightly more on tobacco products than poorer individuals, and as a percent of their income, the rich spend much less.

Moreover, the estimates above almost certainly underestimate the regression of tobacco excises in the United States, since the Federal tobacco taxes are not *ad valorem* taxes. Wealthier individuals may smoke no larger quantity of cigarettes or cigars than poorer persons, but they pay more for each cigarette or cigar smoked, since they buy more expensive brands. Since the tax per package of cigarette is the same regardless of price, the actual tax paid by rich cigarette smokers may be little different in actual dollars than that paid by poor smokers, meaning the tax has the same extremely regressive qualities as a head tax. Yet the tobacco tax is probably even less equitable than a head tax, which at least has the virtue of being "fair" on horizontal equity grounds (everyone pays it.) The tobacco tax heavily burdens some poor Americans, while it lets others off without paying a penny.

The discussion above, for cigarette excises, applies also to other major forms of excise taxes, notably alcohol and gasoline. For example, relating to the regression issue, we used the Consumer Expenditure Survey to estimate the income elasticity of alcoholic beverages and gasoline in 1987. The estimate for alcohol was 0.47 percent, and for gasoline (including motor oil) it was 0.44 percent. In other words, a 10 percent increase in income was estimated to increase demand by only between 4 and 5 percent, meaning that upper income consumers pay proportionally less tax than lower income ones. Again, since excise taxes are levied on volume and presumably upper income consumers buy more expensive brands (especially alcohol), the true regression is probably even more pronounced than what expenditure data alone would indicate.

Thus the major excise taxes impose more substantial burdens on lower income individuals than on the more affluent members of society. The lower income members of society tend to be disproportionately minorities and women, as Figure 2 indicates.

Figure 2



Excise taxes especially burden groups in society that government has attempted to protect economically. For government to engage in programs, such as affirmative action, which attempt to improve the economic status of minorities, yet at the same time approve tax increases which harm these groups substantially, seems to make little sense.

Summarizing, we would conclude that the major excise taxes levied in the United States today are highly regressive. Increased reliance on such taxes would violate what seems to be commonly accepted notions of equity or fairness. Any attempt to finance deficit reduction through increasing existing excises would serve to increase the relative as well as absolute tax burden of lower income Americans in general and minority groups in particular.

EXCISE TAXES AND CITIZEN WELFARE

Economists have long condemned excise taxes for promoting economic inefficiency, lowering the economic welfare of the nation below what it otherwise would be. We would note that there are two general approaches to analyzing economic inefficiency. The traditional or "micro" approach looks specifically at a given excise tax and the narrow impact it has on consumers, producers and government. That is the approach considered in this section. A second approach, considered later in this study, is to explore more globally the impact of excise taxes, looking at secondary and tertiary effects of the taxes on other sectors of the economy in order to note the overall "macro" effects of the taxes. This "macro" approach is also sometimes called the "general equilibrium" approach, incorporating a small measure of dynamic change in behaviors that follow from the interaction between groups in a complex economy.

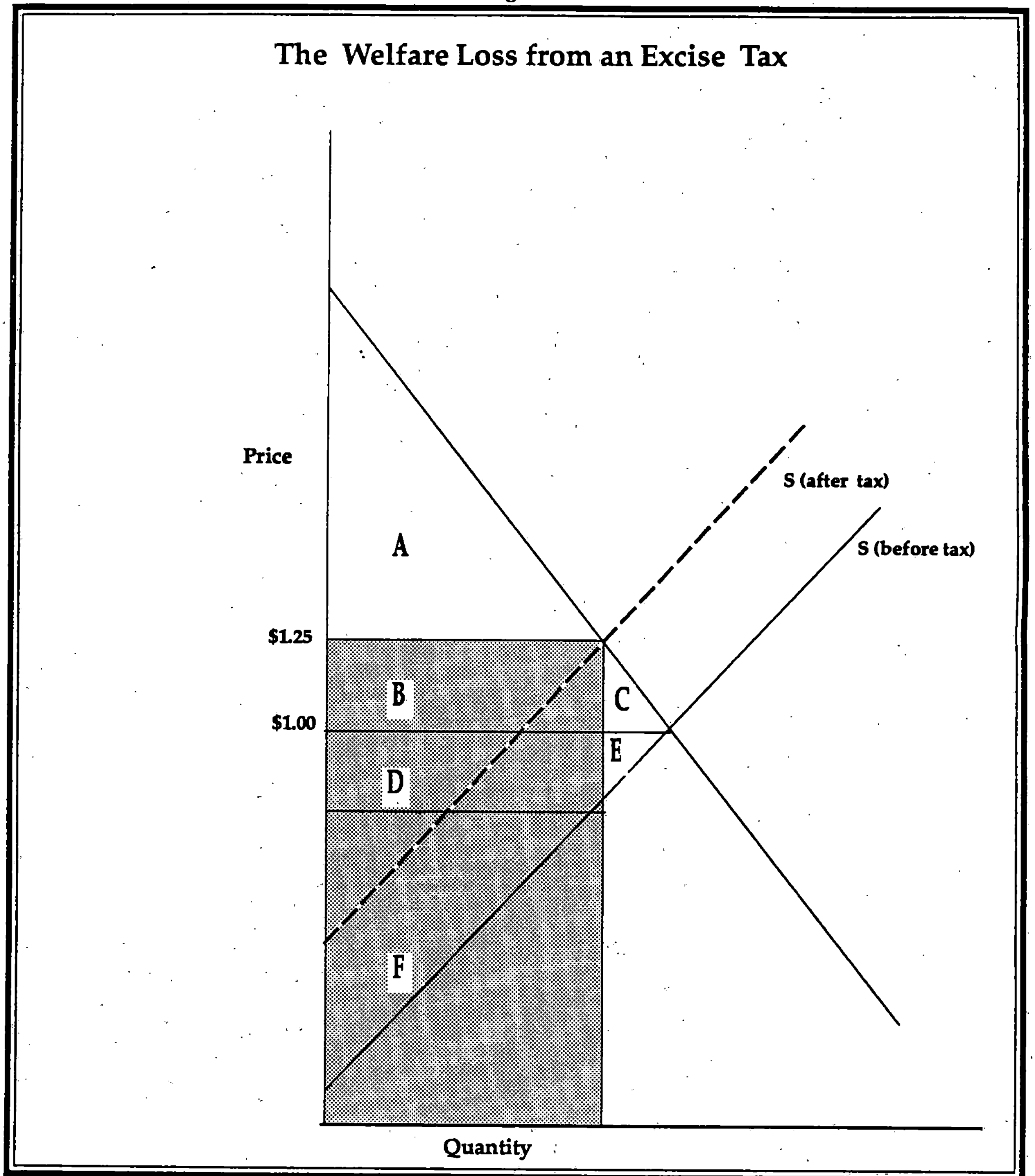
Turning first to the micro effects, excise taxes apply to only select products or services. The imposition of an excise tax increases the prices for these goods relative to non-taxed goods, leading consumers to buy less of the taxed commodities or to substitute purchases of non-taxed goods or services or to forego consumption of other goods in order to afford highly taxed ones. The tax adversely reduces the welfare of the consumer in two ways. First, if the individual buys a taxed commodity after the imposition of the excise tax, his or her income available for other purchases is reduced. Second, if the tax-induced increase in the price of a good leads the individual to substitute a non-taxed commodity for the taxed one, the person's after tax income is the same, but he or she is buying a "bundle of goods" less desirable than the one which would have been purchased if the tax were not present.

With excise taxes, the price system informational function of providing signals to buyers and sellers does not work as well, as "equilibrium quantities" of the taxed product tend to fall not because of diminished consumer taste for the good or because of an increase in the cost of resources needed to produce the good brought about because of increased scarcity, but simply because of the distortional behavior of the government imposed tax. Both an "income" and "substitution" effect work to reduce consumer welfare.

Much of the welfare that consumers receive comes from the fact that most individuals are able to buy a product for <u>less</u> than they are willing to pay for it. For example, an individual might be willing to pay $1.50 a pack for cigarettes, but if he or she can get a pack for $1, the individual derives a benefit of 50 cents—that benefit is called consumer surplus. Excise taxes, by raising the price of commodities, lower the consumer surplus or the net welfare derived by consuming citizens. The next section shows how the gains to the government in tax revenue are <u>less</u> than the loss of consumer welfare when an excise tax is implemented. In the jargon of economists, there is a "deadweight loss".

Figure 3 (page 14) shows how the imposition of an excise tax reduces consumer surplus and imposes what is termed a "deadweight loss." The demand curve measures quantity

Figure 3


The Welfare Loss from an Excise Tax
Price
A
S (after tax)
S (before tax)
$1.25
B
C
$1.00
E
D
F
Quantity

demanded of the product at each price. The supply curve S (before tax) indicates producer willingness to supply the product in the absence of taxation. The initial price is indicated to be $1.00 (where the demand and supply curves intersect.) Suppose a tax of, say, 30 cents, is imposed on the product's manufacturer. That manufacturer's cost of selling the product consequently rises, shifting the supply curve to S (after tax). The demand and supply curve will now cross at $1.25. Even though the tax is 30 cents, the producer is initially only able to increase price by 25 cents, and thus a small portion of the burden of the tax is absorbed by the producer, while the remainder is shifted to the consumer.

Consumer Surplus and "Deadweight Loss" from Excise Taxation

Consumer welfare from the consumption of a good is measurable by what economist call "consumer surplus." Consumer surplus is the dollar value of the excess of the value of a product to all consumers over the price the consumers had to pay for the good. Suppose a gallon of gasoline costs one dollar, and some consumer would have purchased the gasoline even if it cost $1.75. That person's consumer surplus is 75 cents per gallon of gas purchased.

If, however, after the imposition of an increased tax on gasoline the price of gasoline goes to $1.25, the individual's consumer surplus falls to 50 cents ($1.75 minus $1.25); the satisfaction to the customer beyond the purchased price has been reduced.

In this example, consumer surplus was initially the areas marked A, B and C. Those areas combined represent the total amount of excess satisfaction that consumers derive from being able to purchase the product for less than they were willing to pay for it. The imposition of the tax lowers consumer surplus to area A. Consumer surplus is reduced by an amount equal to areas B and C. The amount represented by area B, however, goes to the government in the form of tax revenue. If one assumes the government spending derived from the excise tax provides as much citizen welfare per dollar as it did to consumers in the form of consumer surplus, one might say there is no welfare loss from the transfer of B from consumers to government. Area C, however, is simply lost welfare captured by no one—a deadweight loss. It represents an efficiency loss to society from the imposition of the tax.

The analysis is actually more complicated than indicated above. For example, there is something called producer surplus—the excess in revenue producers receive over what they require to produce the good, equal to the sum of areas D, E, and F in Figure 3 (page 14). That is also reduced by imposition of the tax. In addition, government tax revenues are actually slightly greater than indicated by area B (actually they are equal to B plus D). The area D is income previously part of producer surplus that transfers to the government. If one again assumes that the government spending of tax receipts in the amount represented by area D provides citizen welfare equal to the loss to producers, there is no net welfare loss implicit in the transfer of income from producers to the government. However, just as area C represents a deadweight loss of consumer surplus, area E is a deadweight loss of producer surplus. Thus, the total deadweight or efficiency loss associated with excise taxes are the sum of areas C and E in figure 3 (page 14).

The deadweight loss indicated in the figure may well be a conservative estimate of the welfare loss from the excise tax, simply because the assumption that a dollar in government spending provides welfare to citizens equal to the dollar of surplus taken away from consumers and producers is highly questionable.

An important factor in determining the economic effects of an excise tax is the sensitivity of consumers to changes in price. If consumers are highly sensitive to price (meaning that demand is what economists call "elastic"), initially a comparatively large portion of the excise tax will be shifted back to the producer. Because the tax increase greatly reduces product sales in such instances, both consumer and producer surplus is reduced, but the burden falls to a larger extent on producers than when demand is inelastic—consumers are relatively insensitive to price. As we have already observed, demand tends to be highly inelastic for several products with major excise taxes, suggesting that the consumer bears the bulk of the burden of the tax, even in the short run.

Most economists would agree that over long time horizons, the incidence or burden of excise taxes falls on consumers. If part of the burden fell on producers, rates of return on investment in taxed industries would fall below the rate of return in non-taxed (in an excise tax sense) industries, inducing resources to move away from the excise taxed industries, thereby ultimately equalizing the rates of return between the taxed and non-taxed industries.[17] Under these conditions, all deadweight losses are of the consumer surplus variety.

While there seems to be relatively little controversy over the fact that consumer surplus is reduced by excise taxation, creating a deadweight loss, economists still discuss the technicalities of measuring consumer surplus.[18] Most of the criticisms of the use of the concept in measuring welfare loss have been effectively refuted by Arnold Harberger, the pioneer in this form of analysis.[19] Harberger has demonstrated that the welfare loss of excise taxation can equal up to one-half the revenue gain to government from such taxes. Thus an excise tax that raises $1 billion in revenues may impose $500 million in welfare costs on consumers.

Harberger further addresses the question whether the welfare losses associated with indirect (excise) taxation are greater than those imposed by income taxes. He concludes that:

> *By and large the traditional preference for direct over indirect taxation is justified, and that the simple textbook measure of welfare cost (the triangle under the demand curve) yields a good first approximation in most cases.*[20]

Excise Taxes and Governmental Growth

While most experts in public finance abhor excise taxes since they violate standard principles of economic neutrality and efficiency, James Buchanan and Geoffrey Brennan have suggested another argument that might be used against excise taxes.[21] If one views the government as an inefficient monopoly provider of certain public services, any form of taxation that serves to promote the growth of the relatively inefficient governmental sector at the expense of the more competitive and efficient private sector might be said to be "inefficient".

A revenue maximizing monopolist (be it a private company or a government) will maximize revenue by practicing price discrimination—charging those customers who desperately need the product a high price, and those customers whose demand for the product is highly price sensitive, a lower price. Thus movie theater operators charge adults who are less price sensitive more for shows than children whose demand is relatively price elastic. Similarly, governments can charge, via excise taxes, higher "prices" for products for which demand is highly inelastic than for other products, which are either exempt from taxation or taxed at some lower general sales tax rate. It is no accident that excise taxes are concentrated in areas where demand is highly inelastic—the government can enhance its revenue without driving the customers away. To the extent that using price discrimination enhances government revenues and crowds out a more productive private sector activity, it is inefficient.

Efficiency and External Costs

In our judgment (and that of many scholars in the field of public finance) the most intellectually respectable argument for imposing a selective sales-type tax is that some activities have "negative externalities" or social costs associated with them that are borne by third parties, so that the price system does not fully reflect the true social cost of the good in question. Such arguments are used in explaining several forms of governmental intervention in market processes, for example environmental regulation. It is argued that because much of the cost of pollution is borne by residents of the community where the product is produced, and those costs are not fully reflected in the supply of the product (since the producer does not have to pay them), intervention in market-determined solutions is justified.

Similar reasoning might be used to justify excise taxes where there is some external cost associated with the product, costs not borne by the consumer or producer. In reality, however, there are severe problems with imposing excise taxes to take account of social costs of activities that are not reflected in market prices. Consider, for example, an excise tax on wine. It might be argued that heavy wine consumption can impose external costs, such as when a drunk driver injures an innocent third party. Yet the American legal system provides amply (some would say too amply) for injured individuals to be compensated for damages imposed by over consumption of alcohol. Beyond that, however, there is even some evidence that very moderate consumption (one glass a day) of wine may be medically beneficial, that such consumption imposes absolutely no social costs, and that there is no justification for discouraging such consumption on some external cost/health risk grounds. An excise tax that discourages that form of consumption is clearly non-optimal. Yet it is impossible to impose a tax that reaches only the "bad" consumers of wine without burdening the "good" consumers. Thus even if one could envision situations where an excise tax might serve to improve resource allocation, it is virtually impossible typically to implement such a tax without having some accompanying negative resource allocation effects.

THE MACROECONOMIC EFFICIENCY EFFECT OF EXCISE TAXES

Too often tax analysts fail to take into account the "dynamic" effects of the changes that occur. Sometimes, human behavior is assumed to be unaffected by tax changes. Thus static calculations of the impact of lowering capital gains taxes inevitably show revenue losses to the government, whereas models that realistically take account of behavioral changes accompanying tax reductions show revenue increases. For example, over-reliance on static models led to consistent under prediction of the tax revenues received from upper income individuals from the marginal income tax reductions of the 1980's. Also, sometimes analyses fail to consider the secondary or tertiary impact that taxes have led to behavioral changes in areas distantly related to the taxed commodity, capital or service.

An alternative approach to the measurement of the efficiency dimensions of taxes is to incorporate the tax structures in a general equilibrium model of the entire economy. Simply put, a general equilibrium model is a representation of the full economy, including private consumption and production sectors plus government and foreign trade sectors. Such a broad based view of the relationships of an economic system has the advantage of being able to describe the total impact of taxes, including the interplay between taxes, patterns of consumption spending, and shifts in the usage of resources. Thus, such a model includes a great variety of considerations on both the demand and supply side of an economy's market.

Interest in the general equilibrium approach to analyzing economic events has been on the rise since the end of World War II. The pioneers in this research include Arnold Harberger and Harry G. Johnson who developed numerical versions of general equilibrium depictions of the American economy.[22] Since that time, models of this sort have become more elaborate as the computational techniques for solving them have become more sophisticated. There are a number of examples of models that have been employed to assess the effects of various types of taxes on the overall economy.[23]

This is done by 1) calculating the outcome of such a model for a bench-mark year using known estimates of a variety of economic relationships and known values of economic data for that year, including tax rates, 2) replacing the values for the tax rate and structure inputs into the model with a hypothetical new set of values, such as those reflecting new taxes enacted into law subsequent to the bench-mark year of the model, and 3) recalculating the outcome of the model using the changed tax inputs.

The result of step three represents a counter-factual estimate of what the economy would look like once all adjustments to a new general equilibrium have occurred. Consequently, it describes the potential long run outcome of a change in the tax system. In a 1984 survey article detailing the nature of computable general equilibrium models, the authors concluded that:

> *A general theme seems to be that efficiency costs (deadweight losses) of taxes may be more severe than has previously been supposed.*[24]

This indicates that the partial equilibrium efficiency losses that already have been described represent lower bound estimates of the economic inefficiencies introduced by the imposition of excise taxes.

An additional virtue of general equilibrium models is their capacity to provide us with dynamic estimates of the impact of tax policy changes on tax revenues. This is in sharp contrast to the somewhat mechanistic static type, or partial equilibrium, estimates that dominate so much of tax-policy assessment when new departures in taxation are being considered. A recent study that reports both a partial and a general equilibrium analysis of the impact of proposed increases in tobacco and alcohol excise taxes illustrates quite well the differences between the two approaches and the insights provided by the general equilibrium technique.[25]

The partial equilibrium form of analysis indicates that raising the cigarette excise tax from 16 to 32 cents a pack and the taxes on beer and wine to the level on distilled spirits would produce approximately $1.3 billion in additional revenue annually for the Federal Government. However, when tracked through a computable general equilibrium model, the revenue gains to government are much less, falling by approximately a half billion dollars, or by about 40 percent. According to the authors, the traditional partial equilibrium (static) model "fails to allow consumption and production to migrate into lightly taxed sectors."[26] In other words, traditional analysis fails to account for behavioral changes to taxes on both the demand and supply sides.

Support for the broad thrust of the findings that emerge from the general equilibrium assessments of the impact of taxes on the economy, especially those dealing with efficiency losses, is provided by other macroeconomic evidence of a non-general equilibrium character. Simple comparisons of patterns of economic growth and levels of government expenditure and taxation are quite revealing in this respect. On the expenditure side, the basic issue is whether government outlays have positive or negative effects on overall levels of economic activity. Consistent with Buchanan and Brennan, Milton Friedman argues that the critically important dimension of the taxation-spending nexus is the size of government relative to the economy as a whole. His view is that government activity is inherently inefficient because it absorbs resources from the private sector in a fashion that is not subject to the rigors of being tested in the market place. On the other hand, it is sometimes argued that government spending has the potential for increasing economic growth by improving the infra-structure of the economy—by providing better roads, for example or by improving the quality of the labor force and stimulating technological progress by providing more education.[27]

While some government outlays might stimulate economic growth, the important question is the total effect of these expenditures on economic activity. Here, the evidence is quite convincing that government expenditures are growth inhibiting. For example, James Barth, Michael Bradley, Lowell Gallaway and Richard Vedder have demonstrated that on an economy wide basis, using time series data or cross-country comparisons, high levels of government activity slow economic growth[28]

On the other side of the coin, a large number of studies indicate, using both US and international data, that levels of taxation also impact negatively on economic growth.[29] The most comprehensive recent treatment is that of Lawrence Lindsey.[30] Among these studies, the majority identify a negative relationship between the average rate of taxation and measures of economic growth, although some focus is on the effect of higher marginal tax rates.

Collectively, these studies indicate that higher levels of taxation, of whatever type, are a "double whammy" on the economy, depressing levels of economic activity because of the impacts of the taxation itself, and additionally because of the implicit inefficiencies that emerge from government spending. One of these investigations includes both the levels of taxation and government spending in an explanation of the growth in the average productivity of labor in the United States. As already indicated, higher levels of either of these measures are associated with slower rates of productivity growth.

The negative impact on economic growth of both government spending and the average rate of taxation is extremely significant with respect to excise taxes. Additional excise taxes increase the average level of both taxation and as the next section indicates, government spending and consequently, retard economic growth.

There are further potential macroeconomic effects of excise taxes. For example, consider the implications of substantial increases in excise taxes on the most popular targets for such levies as alcohol, tobacco and gasoline. These taxes will be shifted forward to consumers, especially in the long run, through higher prices for the taxed commodities. Collectively, these products account for about 6 percent of all consumption expenditures.[32] Thus, a 20 percent increase in their price as the result of a large increase in excise taxes would, by itself, directly produce an increase in consumer prices of more than 1 percent. To be sure, it would only be a one time change and not an increase in the longer term inflation rate.

Such an inflationary impact would no doubt lead to an increase in nominal interest rates, heighten inflationary expectations and cause other potential damage to the economy. Should nominal interest rates rise by one percentage point (100 basis points), the increase in debt service costs to the government (estimated to be about $5.5 billion) could largely offset the revenue effects of the taxes.[32] Thus the initial deficit impact of a tax increase could well be small or possibly even negative, even ignoring the possibility that the tax increases would induce increases in government spending.

Of course, in general, all taxes are inflationary in that they slow economic growth. Given the same money supply, a lower level of real output implies a higher price level. This dimension of the impact of higher taxes, especially excise taxes, is the familiar "supply-side" notion that inflation is diminished by stimulating economic growth through the lowering of taxes.

In summary, the macroeconomic efficiency implications of higher excise taxes are quite substantial and dominantly negative. Moreover, this conclusion does not even take account of a more traditional argument that many economists would make against excise tax initiatives at this time: the American economy is growing very sluggishly, and a tax increase will tend to have a negative impact on aggregate demand for goods and services, increasing the probability of a recession.[33]

WOULD INCREASED EXCISE TAXES LOWER THE BUDGET DEFICIT?

President Bush's recent statements indicating a willingness to raise taxes have occurred within the context of the "summit" talks aimed at reducing the size of the federal budget deficit. In this section, we argue that the modern fiscal history of the United States gives us considerable reason to be skeptical of the effectiveness of increased taxation as a deficit reduction device.

Is Federal Budget Deficit Reduction An Appropriate Goal?

Before analyzing the tax-deficit relationship, it is worth briefly noting that the fundamental premise that federal deficit reduction is desirable is considered flawed by many scholars, on two grounds: faulty measurement of deficits and the non-relationship of deficits to important real or financial variables. Regarding the first point, there is considerable concern that the modified cash flow approach to measuring the federal budget deficit is conceptually flawed. To mention just three oft-cited problems, the budget fails to appropriately segregate capital expenditures, it incorrectly accounts for contingent liabilities such as loan guarantees or pension obligations, and it measures only federal, not total public sector activity. Moreover, the real liability of the reported nominal deficit is substantially distorted in an upward direction by inflation.[34] In short, stated deficit amounts are grossly distorted.

Moreover, some would answer the question "do deficits matter?" largely in the negative. A classic article by Robert Barro argues that planned federal deficits lead to altered human saving behavior that tends to offset the interest rate-enhancing effects of federal deficit activity.[35] There are many studies that are consistent with the "new classical" view that deficits have no discernible interest rate effects.[36]

Impact of Taxes on Federal Deficits

Let us assume, however, that the various concerns about the measurement and the impact of the federal deficit are misplaced. Let us make the tenuous assumption that the federal deficit is appropriately measured and constitutes an economic problem. Will raising excise (or any other) taxes alleviate the problem?

There is considerable historical evidence that increases in federal government revenues are <u>not</u> associated with reductions in budget deficits. Indeed, along with Christopher Frenze, we presented evidence for the 1947-86 period that suggests there is $1.58 in new federal spending associated with each $1 in new federal revenues.[37] An exact replication of that study, with minor corrections for revised data and including the 1987, 1988 and 1989 fiscal years, raises the estimate to $1.72—each dollar of added taxes actually increases the deficit by 72 cents.

Alternative model specifications using different time periods do not confirm the extremely strong conclusion that new taxes actually lead to increased deficits, but they are generally consistent with the view that new taxes do not lower the deficit. Even the weakest finding that we obtained suggests a majority of new tax revenue is spent, meaning that new taxes are an ineffective means of deficit reduction.

Some confirmation of this observation is provided in Table 5, which shows the proportion of gross national product absorbed by federal receipts (mostly taxes), as well as the deficit (calculated for calendar years on a national income accounts basis) as a percent of GNP. Note that with the passage of time the proportion of national output absorbed by taxes consistently rises—as does the federal deficit as a percent of GNP.

The issue of the tax-deficit relationship has been extensively investigated by others. A key issue is the direction of causation: do taxes induce more government spending, or does more government spending induce new taxes? Although the evidence is not unambiguous, several studies have concluded that causality runs between taxes and spending—that a dollar of new taxes does not bring about a dollar of deficit reduction in the long run.[38]

Table 5

Federal Receipts and the Federal Deficit, 1950-1989

Decade	Federal Receipts as % of GNP*	Federal Deficit as % of GNP*
1950's	18.26%	-0.11%
1960's	18.86	0.29+
1970's	19.27	1.74
1980's	19.91	3.78

*Calendar year, national income accounts basis; numbers represent the unweighted average of 10 years of data. +Surplus.
Source: Authors' calculation from data contained in the 1990 Economic Report of the President (Washington, DC: Government Printing Office, 1990.)

Why do tax increases often fail to get translated into equivalent reductions in federal deficits? Legislators presumably value their jobs, and new taxes jeopardize job security by angering voters. To offset the political damage caused by new taxes, politicians feel compelled to increase government spending to offset the negative impact of new taxes. For example a dollar of new taxes approved in February, might induce a dollar (or some other amount) worth of new spending in September. Vote-maximizing political entrepreneurs probably face some "optimal" budget deficit that minimizes the possibility of electoral defeat. That "optimal" or "natural" deficit is almost certainly currently greater than $100 billion a year, and perhaps exceeds $150 billion.

Politicians are not likely to jeopardize job security by approving fiscal policies markedly deviating from the vote-maximizing optimum. While the Gramm-Rudman-Hollings limits may impact on the optimal deficit size, the evidence to date is that their impact is minimal— targets will be changed, deadlines stretched, etc., if necessary to prevent job-security endangering fiscal policies from occurring. It is interesting to note that where balanced budget constitutional amendments exist at the state and local level, the causality between taxes and subsequent spending increases is not observed.[39]

Summarizing, even if excise taxes were considered "good" taxes on efficiency, equity

EVALUATING EXCISE TAXES ON OTHER CRITERIA

While traditionally taxes have been evaluated on administrative cost, economic efficiency, and equity criteria, there are other considerations that some scholars believe should be considered. For example, Stiglitz suggests a tax could legitimately be evaluated on its flexibility and on its political responsiveness.[40]

According to the "flexibility" criteria, it is better, other things equal, to have a tax whose revenues rise in response to rising income than one that is relatively inflexible. We should note, however, others would disagree with this assertion.[41] Nonetheless, it is clear that, in general, excise taxes are <u>not</u> good taxes by the flexibility criteria. As indicated above, the income elasticity of demand is low for most major products subject to excise taxes in the United States. As income levels rise by 10 percent, expenditures on the products rise less, so tax revenues do not automatically increase. The historical data presented in table 1 (page 3) are also consistent with this interpretation.

The political responsiveness criteria noted by Stiglitz has been emphasized by writers of the public choice school. Other things equal, a good tax is one about which voters are aware. On this criteria, the individual income tax is good since taxpayers know exactly the financial consequences of the tax and can evaluate it accordingly in making voting decisions. The corporate income tax is bad because it is unclear who pays it. While the incidence of excise taxes is generally known (where demand is inelastic, the tax is quickly passed forward to consumers), the amount of the tax is often not known to consumers. Thus purchasers of alcohol, cigarettes and gasoline pay heavy taxes, but the tax proportion of the price is not separated (as is usually the case with general state and local level sales taxes), so the taxpayer-voter is not fully aware of the tax. Thus excise taxes do not rank terribly high in terms of their political responsiveness.

CONCLUSIONS

In the coming months, Congress and the Administration are expected to ask Americans to support the imposition of more than $25 billion in new excise taxes on commodities such as beer, wine, tobacco, securities transfers, gasoline, energy and the like. These new taxes will be sold as necessary to reduce the budget deficit, now estimated to exceed $168 billion this year. Some of these taxes will be billed as the government's effort to discourage selected behaviors. Whatever the justification, these taxes represent the worst policy options available.

We know that excise taxes are regressive–that they most adversely affect the working poor, minorities, the middle class, working women, the elderly and those on a fixed income–those who have the least ability to pay. We also know that tax increases have the perverse effect of increasing the deficit in two ways: first, for every dollar in new tax revenue Congress will increase spending by $1.72; and second, $25 billion in new taxes will almost certainly drive interest rates up which in turn drives the cost to service existing federal debt up as well. Already, every dollar in tax revenue collected West of the Mississippi is earmarked for interest payments on the national debt.

The problems is spending not revenue. In this fiscal year the federal government will collect 19.3 percent of GNP and next year an estimated 19.5 percent. These numbers are at or near the post-war high and certainly suggest that Americans are paying more than enough to support their government. This suggests that Congress should either make the tough decisions and cut spending or allow the Gramm-Rudman-Hollings automatic spending cut plan to make the choices for them. Undeniably, the Gramm-Rudman mechanism is imperfect, but it is equally undeniable that it works and has given us the only real spending reduction in recent years.

As such it is clear that the case for new excise taxes can not be made with any credibility. Perhaps it is apt to describe these as the fiscal equivalent of the hubble telescope–an expensive plan that won't work. By any reasonably equity criteria they are viciously unfair to certain groups in the economy who neither desire nor deserve the added burden which these taxes will impose; they do not achieve the objective of reducing arguably undesirable social behaviors; and, they will increase, not reduce, the federal deficit. As such they are inconsistent with notions of a kinder gentler American, and are likely to create alienation of lower income Americans from the political system.

Based on these criteria, we believe that the imposition of new excise taxes are unwarranted on almost every possible economic and policy basis.

ENDNOTES

[1]See U.S. Bureau of the Census, Statistical Abstract of the United States:1990 (Washington, D.C.: Government Printing Office, 1990), p. 310.

[2]Ibid., p. 313

[3]The Grahm-Rudman-Hollings sequester mechanism is also suspended in times of war.

[4]Dan Rostenkowski, "Combine Spending Restraint with Taxes to Reduce the Deficit," Tax Features, 34 (May, 1990).

[5]The cigarette tax went from eight to sixteen cents a pack. The telephone tax was increased from one to three percent. For airfares, a $3 surcharge per ticket was added (and doubled again in 1990) and the tax rate on the fare was increased from five to eight percent.

[6]The liquor levy amounted to about $0.35 per fifth of liquor.

[7]Among standard accounts in public finance that speak to the economic difficulties with excise taxes are Edgar K. and Jacquelene M. Browning, Public Finance and the Price System (New York: Macmillan, 1987); Richard A. Musgrave, The Theory of Public Finance (New York: McGraw Hill, 1959), and Joseph Stiglitz, Economics of the Public Sector (New York: W.W. Norton, 1986.)

[8]U.S. Department of Labor, Bureau of Labor Statistics, Consumer Expenditure Survey: Integrated Survey Data, 1984-87, Bulletin #2333 (Washington, D.C.: Government Printing Office, 1989.)

[9]Musgrave, Supra note 7 at 151.

[10]Joseph A. Pechman, Federal Tax Policy, Fifth Edition (Washington, DC: Brookings Institution, 1987) p. 194.

[11]McWre, C. and Thirsk, W: "The Inequity of Taxing Iniquity: A Plea for Reduced Sumptuary Taxes in Developing Countries," Economic Development and Cultural Change, April, 1978, pp. 487-488.

[12]Historically, some economists have argued that excise taxes could be shifted backward to owners of capital. See, for example, Harry Gunnison Brown, "The Incidence of a General Output or a General Sales Tax," Journal of Political Economy, April 1939, or Earl R. Rolph, "A Proposed Revision of Excise Tax Theory," Journal of Political Economy, April, 1952.

[13]Tony McGuiness and Keith Cowling, "Advertising and the Aggregate Demand for Cigarettes," European Economic Review, July, 1975.

[14]See Badi H. Baltagi and Dan Levin, "Estimating Dynamic Demand for Cigarettes Using Panel Data: The Effects of Bootlegging, Taxation and Advertising Reconsidered," Review of Economics and Statistics, February 1986, and Barry J. Seldon and Khosrow Doroodian, "A Simultaneous Model of Cigarette Advertising: Effects on Demand and Industry Response to Public Policy," Review of Economics and Statistics, November, 1989.

[15]See Hendrik Houthakker and L. Taylor, Consumer Demand in the United States, 1929-70 (Cambridge, Mass.: Harvard University Press, 1966), and H.L.Lyon and Julian Simon, "Price Elasticity of Demand for Cigarettes in the United States," American Journal of Agricultural Economics, November, 1968.

[16]Our own estimate of income elasticity is 0.18, meaning a 10 percent increase in income is associated with only a 1.8 percent increase in tobacco usage. An identical estimate has been obtained for Sweden. See A. Koutsayannis, "Demand Functions for Tobacco," Manchester School, January 1963. Some other early estimates were higher, but still well below 1.0. See, for example, the Wharton School, Study of Consumer Expenditures, Incomes, and Savings (Philadelphia: University of Pennsylvania, 1966) and J.L. Hamilton, "The Demand for Cigarettes: Advertising, the Health Scare, and the Cigarette Advertising Ban," Review of Economics and Statistics, November 1972. More recent estimates of elasticity have been between .27 and .32. See Seldon and Doroodian, op.cit., McGuiness and Cowling, op.cit., and Richard Schmalensee, The Economics of Advertising (Amsterdam: North-Holland Publishing Co., 1972.)

[17]Where industries are not characterized by ease of entry or exit, or where substantial non-competitive

profits exist, that conclusion may not hold. There is little evidence, however, that those conditions characterize most industries subject to excise taxation.

[18]Two representative modern studies include Jerry A. Hausman, "Exact Consumer's Surplus and Deadweight Loss," American Economic Review, September 1981, and Robert Willig, "Consumer's Surplus Without Apology," American Economic Review, September 1976.

[19]See Harberger: Taxation and Welfare (Boston: Little, Brown, 1974). Also of interest is his "The Incidence of the Corporation Income Tax," Journal of Political Economy, June, 1962.

[20]Taxation and Welfare, Supra note 19 at 53.

[21]James Buchanan and Geoffrey Brennan, The Power to Tax (Cambridge: Cambridge University Press, 1980).

[22]See, for example, Harberger's "On the Incidence of the Corporation Income Tax," Supra note at 19, and Johnson's "The Gains from Freer Trade with Europe: An Estimate," Manchester School, September, 1958.

[23]See, for example, Charles Ballard, Don Fullerton, John B. Shoven and John Whalley, General Equilibrium Analysis of U.S. Tax Policies (Chicago: University of Chicago Press, 1985), or John B. Shoven and John Whalley, "Applied General-Equilibrium Models of Taxation and International Trade," Journal of Economic Literature, Sepetember, 1984.

[24]Shoven and Whalley, op. cit., p. 1048.

[25]Roy Boyd and Barry J. Seldon, "Revenue and Land Use Changes in Sin Taxes: A General Equilibrum Perspective" (Athens, OH: Ohio University Economics Department Working Paper, 1990.)

[26]Ibid., p. 10.

[27]Education is considered a means of augmenting "human capital", but the precise impact that educational spending has on human capital formation is debatable. Eric Hanushek has observed that the relationship between public education spending and learning is very weak. See his "The Economics of Schooling," Journal of Economic Literature, September, 1986.

[28]James R. Barth and Michael Bradley, "The Impact of Governmental Spending on Economic Activity," (Washington, D.C.: National Chamber Foundation, 1988); Lowell Gallaway and Richard Vedder, Poverty, Income Distribution, The Family and Public Policy (U.S. Congress, Joint Economic Committee, Washington, D.C.: Government Printing Office, 1986), and also their "Rent-Seeking, Distributional Coalitions, Taxes, Relative Prices and Economic Growth," Public Choice, Vol. 51, 1986.

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[30]Lawrence B. Lindsey, The Growth Experiment: How the New Tax Policy Is Transforming the U.S. Economy (New York; Basic Books, 1990). For an excellent review of Lindsey's work, see Lawrence Kudlow, "Why the Voodoo Worked," Fortune, June 4, 1990.

[31]See U.S. Department of Labor, op.cit.

[32]The total deficit impact of induced inflation will differ from the interest cost effects, since inflation will change both revenues and expenditures. The point being made here, however, is that the projected revenues from excise taxes may be seriously overstated because of the failure to fully take account of the secondary and tertiary effects of the tax initiatives. The $5.5 billion estimate is based on the assumption that about $550 billion in federal debt is less than one year in duration, that inflationary increases of one percent will result in a corresponding increase in interest rates, and that therefore the interest costs to the federal government will rise by $550 billion times .01, or $5.5 billion. On the term structure of the federal debt, see the 1990 Economic Report of the President, p. 393.

[33]Traditionally, Keynesian economists would advocate increasing budget deficits through tax cuts and spending increases to deal with sluggish employment growth, a slowdown in industrial output increase, etc. Ironically, the current proposed remedy is the opposite to the one advocated by most economists in recent decades.

[34]The leading proponent of this perspective is Northwestern University economist Robert Eisner. See, How Real Is the Federal Deficit? (New York: Free Press, 1986) and The Total Incomes System of Accounts (Chicago: University of Chicago Press, 1989.)

[35]Robert J. Barro, "Are Government Bonds New Wealth?" Journal of Political Economy, November/ December 1974.

[36]To cite just seven examples, see Paul Evans, "Do Large Deficits Produce High Interest Rates?" American Economic Review, March 1985; Evans, "Interest Rates and Expected Future Budget Deficits in the United States," Journal of Political Economy, February 1987; Evans, "Do Budget Deficits Raise Nominal Interest Rates? Evidence from Six Countries," Journal of Monetary Economics, September 1987; Gregory P. Hoelscher, "Federal Borrowing and Short-Term Interest Rates," Southern Economic Journal, February 1983; Charles I. Plosser, "Government Financing Decisions and Asset Returns," Journal of Monetary Economics, May 1982; Plosser, "Fiscal Policy and Term Structure," Journal of Monetary Economics, September 1987, and Ali F. Darrat, "Structural Federal Deficits and Interest Rates," Southern Economic Journal, January, 1990.

[37]Richard Vedder, Lowell Gallaway and Christopher Frenze, "Federal Tax Increases and the Budget Deficit, 1947-86: Some Empirical Evidence," Congressional Record, April 30, 1987.

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[39]See Ram, op.cit., and Neela Manage and Michael L. Marlow, "Expenditures and Receipts: Testing for Causality in State and Local Government Finances," Public Choice, Vol. 53, 1987.

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[41]Buchanan and Brennan, Supra note 21.

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MEMO

The Heritage Foundation

To: Executive Branch Policymakers

From: Dave Mason, Director, Executive Branch Liaison

Date: August 1, 1990

Subject: New Taxes = New Spending

A lot of us have been saying that new taxes will not be used to lower the deficit. Here's the proof. Just as the President broke his promise not to raise taxes, Congress voted billions more in spending increases.

In the enclosed paper, Scott Hodge details how Congress has just created a new entitlement program and expanded another for a total bill of $11.7 billion over five years. Congressional appropriations recently passed include such bare bones items as $214,000 for the Christopher Columbus Quincentenary Jubilee Commission and $50,000 for a national bicycle program manager.

Hodge also points out that the administration has requested expanded budget outlays for less than urgent purposes, such as magnetic levitation and the NEA.

As you consider proposals related to the budget summit, I hope you will keep in mind Congress' reaction to expanded government revenues.

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The Heritage Foundation Backgrounder

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The Thomas A. Roe Institute for Economic Policy Studies

July 25, 1990

WHILE TALKING ABOUT A DEFICIT CRISIS, CONGRESS PROPOSES BILLIONS IN NEW SPENDING

INTRODUCTION

The Bush Administration and congressional leaders involved in the current budget deficit reduction summit claim that the deficit is such a crisis that American taxpayers must give even more of their money to help pay Uncle Sam's bills. Some taxpayers may assume that before policy makers decided on a tax hike, they did everything possible to cut wasteful spending, to eliminate pork barrel projects and to shut down programs that serve no overriding national interest.

Such an assumption would be wrong.

Neither Congress nor the Bush White House has tried seriously to cut spending. Quite the contrary. At this very moment, while they wring their hands about a "budget deficit crisis," policy makers are proposing to spend more money on existing programs and to launch costly new programs. They are pushing federal spending to record high levels. As Washington veterans of the budget process could have predicted, the convening of the budget summit and Bush's broken no-new-taxes promise have opened the floodgates for this spending spree.

Congress's Bad Faith. George Bush betrayed his campaign pledge of no new taxes reportedly as a good-faith measure to convince congressional leaders of his sincere desire to reach an agreement in the budget summit. In the four weeks since then, the liberal-dominated House of Representatives has responded to Bush's gesture by passing six appropriations bills totalling $182.3 billion. This is $18.75 billion over 1990 appropriations levels, a 11.47 percent increase.

If the House continues this trend for the remaining seven appropriations bills required by the Budget Act of 1974, and if these spending levels are matched by the Senate and accepted by the President, total appropriated spending will increase by $75 billion in fiscal 1991. At the same time, the House soundly defeated a series of amendments that would have reduced these proposed spending increases, in some cases reducing these huge increases by as little as 2 percent.

Costly New Programs. The House has not merely increased current spending in appropriations bills. With members smelling blood in the water, the House Ways and Means Committee okayed a new foster care entitlement program which will cost taxpayers more than $4 billion over the next five years. The House Agriculture Committee has approved legislation to expand Food Stamp and nutrition entitlement programs by $7.5 billion over five years.

At the same time that many House members have been congratulating Bush for his "statesman-like" betrayal of his no-tax pledge, they have been quietly adding spending to the budget that could cost every American household $750. Yet, nowhere in any of these bills have members of Congress attempted to cut spending.

The message is clear.

Congress does not want new taxes for deficit reduction.

Congress wants new taxes for new spending.

CONGRESSIONAL BETRAYAL

In April, Bush invited congressional leaders to a "budget summit" to negotiate a good-faith deal to bring the projected fiscal year 1991 deficit of $168 billion down to the $74 billion level[1] required by the 1985 Gramm-Rudman-Hollings deficit reduction act, a level that does not include the cost of bailing out ailing savings and loans.

Rather than trying to cut wasteful spending, many congressional leaders pressured Bush to betray his no-tax pledge. On June 26, he obliged by stating that it was clear to him that "tax revenue increases" would be needed to bring the deficit in line. What followed has been a spurt of new federal spending in the first six appropriations bills.

Table 1 compares the first six FY 1991 appropriation levels with totals from previous years.

1 The Gramm-Rudman-Hollings deficit target for FY 1991 is $64 billion plus a $10 billion "margin for error."

Table 1
Appropriations Bills
($billions)

BILL	FY '89 Approps.	FY '90 Approps.	FY '91 Bush Proposal	FY '91 Approps.	$ Change '90-'91	% Change '89-'91	% Change '90-'91
Commerce/ Justice	14.85	11.70	11.10	10.50	-1.20	-29.30	-10.20
Energy/Water	17.83	18.43	20.20	20.77	+2.40	+16.52	+12.70
Foreign Operations	14.29	15.52	15.52	15.78	+0.30	+10.46	+1.69
VA/HUD	59.39	71.28	78.78	83.57	+12.30	+40.72	+17.25
Transportation	25.67	28.17	26.73	30.94	+2.70	+20.54	+9.50
Treasury/P.O.	16.02	18.45	20.71	20.72	+2.27	+29.34	+12.30
TOTALS	148.05	163.55	173.34	182.31	+18.75	+23.14	+11.47

CONGRESS REFUSES TO TRIM INCREASES

When some lawmakers attempted to slow the proposed increase in spending, Congress ignored them. By substantial majorities, the House of Representatives soundly defeated a series of amendments that would have rolled back proposed spending increases at various levels. Defeated were amendments to the Energy and Water Appropriations bill as well the Housing and Urban Development-Veterans Administration (HUD-VA) Appropriations bill offered by Representative Bill Frenzel, the Minnesota Republican, that would have nullified the proposed increases and returned spending to inflation-adjusted 1990 levels. The HUD-VA bill, just passed by the House, contains $12.6 billion in new spending.

Congress also has been averse to amendments that would roll back the appropriated increases by much smaller amounts. Representative William Dannemeyer, the California Republican, for instance, unsuccessfully offered amendments for 5 percent across-the-board reductions in appropriations for the Energy and Water bill, Commerce and Justice bill, and the HUD-Veterans Administration bill. And of the five attempts by Representative Timothy Penny, the Minnesota Democrat, simply to reduce appropriated levels 2 percent across-the-board all but one, which amended the Treasury/Post Office bill, were defeated. Even had these amendments passed, however, spending would have increased over fiscal 1990 levels (Table 2).

Table 2 ($ billions)					
BILL	FY '90 Appros.	Frenzel Amendment[1]	Dannemeyer Amendment[2]	Penny Amendment[3]	FY '91 Approps.
Energy	18.43	18.54	19.74	20.36	20.77
HUD/VA	71.28	71.46	79.39	81.90	83.57
Commerce/Justice	11.10	N/A	9.97	10.29	10.50
Transportation	28.17	N/A	N/A	30.33	30.94
Treasury	18.45	N/A	N/A	20.31	20.72
TOTALS	147.43	152.16	160.77	163.18	166.51

1. Representative Frenzel introduced two amendments. One would have cut Energy and Water appropriations by 10.53 percent across the board. The other would have cut HUD/VA appropriations by 14.5 percent across the board, except for VA medical benefits.
2. A 5 percent across-the-board cut.
3. A 2 percent across-the-board cut, except for VA medical benefits and HUD Section 8 housing.

BIG SPENDERS AT THE WHITE HOUSE

Bush cannot blame Congress solely for the alleged need for new taxes. His Administration also has been seeking higher federal spending. Table 3 shows a sample of higher spending requested for current programs.

The Bush Administration is seeking spending authorization for new programs as well. Table 4 offers a sample of these requests.

For years critics of high government spending have pointed to the need to cut or eliminate programs. Yet as Congress looks for ways to increase taxes, it refuses to address the $424 billion in government waste reported by the "Grace Commission" six years ago or the more than $150 billion in program waste, fraud, and financial mismanagement found earlier this year by Congress's own General Accounting Office (GAO). Moreover, nowhere is there evidence that members of Congress attempted to enact the roughly $60 billion in program saving measures recommended this year by the Congressional Budget Office or the $130 billion in program savings recommended by analysts at The Heritage Foundation.

Table 3 Bush Administration Proposals for Spending Increases		
Program	1991 Request	Increase over 1990
National Endowment for the Arts	$175 million	$ 4 million
National Endowment for the Humanities	$165 million	$ 8 million
Smithsonian Institution	$308 million	$41 million
Institute for Museum Services	$ 24 million	$ 1 million
National Gallery of Art	$ 49 million	$ 7 million
Historical Preservation Fund	$ 34 million	$1.4 million

Table 4 Bush Administration New Authorization Requests	
Program	**Requested Amount**
Magnetic Levitation Techology	$10 million
Airport Grants	$1.5 million
Global Change Research	$1 billion
Environmental Protection Agency Operating Budget	$230 million
Goverment Research and Development	$4.5 billion
Manned Missions to the Moon and Mars	$408 million

PROSPECTS OF ENTITLEMENT EXPANSIONS

The serious economic damage that could result from Congress's spending increases is exacerbated by the fact that these 13 appropriations bills represent only about 60 percent of federal budgetary spending. The remainder of the budget is driven by interest on the national debt and, more important, by "automatic" spending such as entitlement programs, which congressmen rarely consider as targets for spending cuts. These programs are expected to grow in 1991 by roughly 6 percent, or $33 billion, to $606 billion. There is the possibility, moreover, that overall entitlement programs will balloon to even higher levels. Since the President broke his no-new-taxes promise, Congress has voted out of committee new entitlements: A Foster Care bill, the Congressional Budget Office (CBO) estimates, will cost $4.2 billion over five years, and expanding the Food Stamp and Nutrition programs will cost $7.5 billion over five years, according to CBO.

The six appropriations bills that the House already has passed are not "bare bones" programs. They are larded with wasteful spending, pork barrel programs, and outdated agencies. If the pork and fat were eliminated and if a spending freeze were imposed on the remaining spending, the budget would be near the $74 billion Gramm-Rudman-Hollings deficit target without harming entitlements.

Congress should analyze each program and spending item by asking:

1) **Does the program serve the nation as a whole?** If it does not, then Congress must ask if the program supersedes the responsibilities of state and local officials. Filling potholes on Main Street and fixing a railroad crossing in Springfield are not roles for Congress.

2) **Does the program or service have an identifiable user?** If so, then the user should be charged a sum equal to the cost of the service, or the service should be "shed" to the private sector as a competitive enterprise. In reality, this means that landlubbers should not have to subsidize Coast Guard services to wealthy yacht owners or that folks in rural America should not have to subsidize the mass transit costs of urban dwellers.

3) Has the program failed, fulfilled its mission, outlived its usefulness, or simply become irrelevant? If so, then these programs should be abolished. Too often Congress continues to fund a program even when Congress's own research groups determine that a program is a failure. If a program has outlived its usefulness or even fulfilled its mission Congress finds new activities for the program to do. Congress hates to abolish programs.

4) Is Congress engaging in central planning or attempting to set "national priorities" that should be left to communities or individuals? Example: the more than $1 million appropriated in this year's Transportation bill to establish a national bicycle program and to encourage safe bicycle riding. Certainly the decision to commute by bicycle or car is an individual one. Moreover, most local park districts already conduct classes for children in bicycle safety.

Before Congress makes another move toward higher levels of spending it owes it to American taxpayers to take a critical look at its spending habits. If Congress simply answers the four questions outlined here it will go a long way toward streamlining federal spending and freeing up sufficient funds to solve today's problems.

CONCLUSION

Congress has sent a clear message to American taxpayers that it wants more money for new spending, not for serious deficit reduction. After passing just the first six of the required 13 appropriations bills, Congress is exceeding last year's spending levels by nearly 12 percent. If this pace continues for the remaining seven appropriations bills, the "controllable" portion of the federal budget will balloon by at least $75 billion over fiscal 1990 levels.

Congress also is sending a clear message to Bush by enacting these increases in addition to the more than $11 billion in entitlement program expansions it has approved. This message is: Spending cuts have been taken "off the table" at the budget summit. Congress will accept nothing less than higher taxes. If Bush needs additional evidence of Congress's intentions, he need but look the fact that Congress refused nine of the ten opportunities it had to simply roll back the proposed increases in the appropriations bills.

Congressional action leads to only one conclusion: The only way to reduce the deficit is for Congress to reject new spending and to trim some existing programs. New taxes will not reduce the deficit. As Congress demonstrates almost every week, new revenues will be used for new spending.

Scott A. Hodge
Grover M. Herman Fellow
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Heritage Foundation research interns John Gurney, Angela J. Hulsey, Geoffrey Manne, and Matt Rawlinson assisted in the preparation of this study.

APPENDIX
THE FIRST SIX 1991 APPROPRIATIONS BILLS

DEPARTMENTS OF COMMERCE, JUSTICE, AND STATE, THE JUDICIARY, AND RELATED AGENCIES

As this appropriations bill is not yet complete, it is difficult to compare to previous spending levels. Nearly $9 billion in authorized program spending remaining to be appropriated by the House Appropriations Committee. But if the spending levels for Commerce Department technology programs recently appropriated by the House are any guide, spending for the finished appropriations bill will outpace last year's levels. For fiscal 1991, the House approved $290 million in spending for these programs and $468 million in fiscal year 1992. The fiscal 1991 spending level marks an 82 percent increase over the $159 million spent this year.

Congress and the budget summiteers should give serious consideration to terminating or reforming the following spending programs within this bill; this list is far from complete.

Department of Commerce

Programs for which funds have not yet been authorized: The Economic Development Administration, the Export Administration, the International Trade Administration, the U.S. Travel and Tourism Administration, the Minority Business Development Agency, and the Technology Administration.

National Oceanic and Atmospheric Administration (NOAA)

Fishing Vessel and Gear Damage Fund: $1,202,000

Fisherman's Contingency Fund: $1,000,000

Zebra Mussel Research: $1,000,000

Stuttgart, Arkansas Fish Farm: $2,850,000

National Telecommunication and Info. Administration

Grants for public TV & radio: $20,833,000

Department of State

Contributions to 52 International Organizations: $787,605,000

Examples: International Jute Organization: $69,000

International Lead and Zinc Study group: $36,000

International Office of Epizootics: $62,000

World Meteorological Organization: $6.6 million

International Sugar Organization: $261,000

Fisherman's Protective Fund: $500,000

Related Agencies

Total Spending: $1,901,419,000

Board for International Broadcasting: $192,586,000

Christopher Columbus Quincentenary Jubilee Commission: $214,000

Commission on Agricultural Workers: $1,457,000

Commission on the Bicentennial of the Constitution: $14,973,000

Federal Maritime Commission: $15,894,000

Marine Mammal Commission: $1,003,000

Small Business Administration: $437,700,000

ENERGY AND WATER DEVELOPMENT APPROPRIATIONS

Appropriations levels for 1991 Energy and Water programs are $2.4 billion more than fiscal 1990 levels, an increase of 12.7 percent. By comparison, fiscal 1990 levels were only $600 million over fiscal 1989 levels, an increase of 3.4 percent.

The Energy and Water Appropriations bill is a case study in pork barrel spending, federal involvement in local affairs, and federal involvement in activities that should be entirely left to the private sector. Congress should consider terminating many programs in this bill, such as the following:

Army Corps of Engineers

* General Investigations: $167,847,000

Examples of Feasibility Studies and Investigations:

Red River Basin Comprehensive Study: $425,000

Red River Waterway, Index, Arkansas: $500,000

Red River Waterway, LA: $1,900,000

Rancho Palos Verdes Landslide, CA.: $500,000

Beaver Creek, Floyd County, Kentucky: $200,000

Clinton River Spillway, Michigan: $225,000

Howard Hansen Dam, Water Storage, Washington: $200,000

Waikiki Beach, Hawaii: $100,000

* General Construction: $1,362,025,000

Examples:

McClellan-Kerr, AR, River Navigation System, Locks and Dams:

1991 Cost: $9,900,000

Total Federal Cost: $584,800,000

Santa Ana River Mainstem, CA:

1991 cost: $65,000,000

Total Federal Cost: $908,000,000

Melvin Price Lock and Dam, IL & MO:

1991 Cost: $29,000,000

Total Federal Cost: $742,400,000

Melvin Price Lock and Dam, Second Lock, IL & MO:

1991 Cost: $75,000,000

Total Federal Cost: $230,000,000

Red River Waterway, Mississippi River to Shreveport, LA:

1991 Cost: $61,636,000

Total Federal Cost: $1,724,000,000

* General Operation and Maintenance: $1,457,488,000

Examples:Beaver Lake, AR: $14,718,000

Tennessee-Tombigbee Waterway, AL & MS: $18,000,000

McClellan-Kerr Arkansas River Navigation System, AR: $22,403,000

Ohio River Locks and Dams, KY, IL, IN, OH, PA, WV: $41,060,000

Keweenan Waterway, MI.: $664,000

East River, NY: $1,410,000

Bureau of Reclamation

General Investigations: $12,926,000

Examples:American River Folsom South Optimization Study, CA: $50,000

Upper Gunnison-Uncompahgre Basin Project, CO: $280,000

Josephine Co. Water Management Improvement Study, OR: $200,000

Technical Assistance to States: $1,350,000

Construction Program: $649,697,000

Examples:Colorado River Basin Project: $201,966,000

Ogden River Project, Utah: $1,954,000

Operation and Maintenance: $231,516,000

Department of Energy Supply, Research and Development Activities: $2,703,272,000

Examples:Solar Energy Programs: $130,430,000

Geothermal and Hydropower: $23,600,000

Electric Energy Systems and Storage: $41,253,000

Nuclear Energy Programs: $313,490,000

Biological and Environmental research: $371,394,000

Magnetic Fusion: $325,300,000

Super Conducting Super Collider: $317,866,000 (Total Estimated Cost of the Program: $5 billion to $8 billion)

Uranium Enrichment Facilities: $1,406,018,000 (Could be sold to the private sector for $1.8 billion.)

The Five Power Marketing Administrations: $326,387,000 (Each could be sold to the private sector for over $1 billion.)

Appalachian Regional Commission: $150,000,000

Delaware River Basin Commission: $681,000

Interstate Commission on the Potomac River Basin: $200,000

Susquehana River Basin Commission: $501,000

Tennessee Valley Authority: $135,000,000 (Could be sold to the private sector for over $5 billion.)

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS

Appropriations for the Treasury and the Postal Service are $2.27 billion higher than 1990 levels, a 12.3 percent increase.

Postal Service: Although the U.S. Postal Service is technically "off budget," the taxpayer will nonetheless spend over $522,734,000 to subsidize the Postal Service.

National Critical Materials Council: $235,000

Advisory Committee on Federal Pay: $207,000

Administrative Conference of the United States: $2,079,000

DEPARTMENT OF TRANSPORTATION AND RELATED AGENCIES

Appropriations for the Department of Transportation and Related Agencies will climb $2.7 billion in fiscal 1991 to a total of $30.9 billion, a 9.5 percent increase.

This bill provides an excellent example of how the federal government subsidizes "gold-plated" local projects, fails to require those who use services to pay for what they receive, and pays for projects which clearly are the responsibility of local governments. Among the many spending items that should be terminated, Congress should consider the following:

Department of Transportation

Office of Small and Disadvantaged Business Utilization: $3,500,000

Transportation Policy and Planning: $6,748,000

Including:$50,000 for a national bicycle program manager

Research on sleep and fatigue in transportation

Coast Guard

Boat Safety: $35,000,000

Federal Aviation Administration

Grants-in-Aid for Airports: $1.4 billion

New Denver Airport: $25,000,000

Dallas/Ft. Worth Airport: $12,500,000

L.A. Basin Facility Consolidation: $76,100,000

$117,509,900 total for airport grants

Federal Highway Administration

Research Programs:

Intelligent vehicle/highway systems: $12,000,000

National bicycling and walking study: $1,000,000

University Transportation Centers: $5,000,000

Railroad-Highway Crossings Demonstration Projects: $14,845,000 Including projects in: Elko, NV, Wheeling, WV, Matamoros, Mexico.

Federal Funds to complete Substitute Highway Projects: $1,646,832,472. Including: San Francisco, Washington, Atlanta, Chicago, New York City, New York City-Trenton, New York City (New Jersey).

Baltimore-Washington Parkway.: $9,900,000

Intermodal Urban Demonstration Projects: $10,000,000

Indiana Industrial Corridor Safety Demo. Project: $3,000,000

Alabama Highway Bypass Demonstration Project: $10,000,000

Kentucky Bridge Demonstration Project: $4,000,000

Virginia HOV Safety Demonstration Project: $8,500,000

Bicycle Transportation Demonstration Project, Macomb County, MI: $1,000,000

Local Rail Service Assistance: $7,000,000

Orange County, CA Monorail System: $1,000,000

Long Island Railroad Intermodal Project: $250,000

Amtrak: $482,000,000

MAGLEV/High Speed Rail: $12,000,000

Urban Mass Transit Administration:

Local Construction Projects: $440,000,000

Including, Los Angeles, Jacksonville, Honolulu, and Atlanta.

Washington, D.C. Metro: $108,000,000

Washington Metro Interest Payments: $51,663,000

St. Lawrence Seaway Development Corp.: $10,500,000

Interstate Commerce Commission: $45,844,000

DEPARTMENTS OF VETERANS AFFAIRS AND HOUSING AND URBAN DEVELOPMENT, AND INDEPENDENT AGENCIES

The $83.58 billion appropriated in this bill represents a massive 17.25 percent increase over 1990 levels and a 40.72 percent increase over 1989 levels. Programs within this bill too often duplicate private sector services, prevent the private sector from operating efficiently, or simply compensate for restrictive regulatory policies at the local level. Congress should consider terminating the following programs:

Department of Veterans Affairs

Construction, Major Projects: $575,456,000, an increase of $45,456,000 above budget estimate

Examples:$7,000,000 new hospital at Detroit

$8,900,000 for nursing home care unit at Lake City, FL

$3,400,000 for a laundry and warehouse at Mountain Home, TN

$8,000,000 for a clinical, outpatient, research, parking and central air conditioning project at Ann Arbor, MI

$800,000 for the advanced planning of a modernization project at Wilkes-Barre, PA

$4,800,000 for the contract documents of a replacement for the ambulatory care facility in El Paso.

$3,100,000 for the design of a psychiatric and outpatient facilities modernization project at Northport, NY

$3,200,000 for the design and site preparation of a clinical addition project at Wilmington

$1,450,000 for planning and site acquisition for a new national cemetery at Albany, NY

$1,506,000 for planning and site acquisition for a new national cemetery in the Chicago area.

$1,690,000 for planning and site acquisition for a new national cemetery in the Cleveland area.

$2,385,000 for planning and site acquisition for a new national cemetery in the Seattle area.

Parking Garage Revolving Fund: Total '91 $28,900,000

Department of Housing and Urban Development

Management and Administration Salaries and Expenses: $816,466,000 Including:

$10,000,000 more staff – FHA

$2,000,000 more staff – In-house Program Evaluation and monitoring

$1,750,000 more staff – Public and Indian Housing programs

Public Housing Reconstruction/New Development: $550,320,000

Independent Agencies

American Battle Monuments Commission: $15,900,000

Consumer Product Safety Commission: $37,109,000

Including:

$950,000 for transfer to the National Institute on Standards and Technology for the Technical Study Group on Cigarette and Little Cigar Safety to design and implement a study to collect data about the characteristics of those cigarettes, ignited products, and smokers that are involved in fires.

$50,000 for travel expenses of individuals in the above mentioned study by the Technical Study Group on Cigarette and Little Cigar Safety.

Environmental Protection Agency: $6,012,175,000

Research and Development: $254,900,00
Including:$1,500,000 to establish solar and renewable energy demonstration projects

$250,000 for research on control of the "Zebra mussel"

Abatement, Control, and Compliance: $1,006,525,000

Including:$1,000,000 for the Rouge River basin non-point source control demonstration

$3,000,000 for lead-based paint studies and support

$1,225,000 for continued work on the Spokane Aquifer

$200,000 for a Southwest Arkansas/Southeast Oklahoma Millwood Basin Water Quality Study.

$1,000,000 for the EPA National Training Center at West Virginia University

$275,000 for the Lake Pontchartrain new wetlands creation demonstration project

Construction Grants/State Revolving Funds: $2,000,000,000

National Aeronautics and Space Administration

Research and Development $6,458,625,000

Including: Space Station: $1705,000,000

Search for Extraterrestrial Life: $6,100,000

National Aerospace Plane: $114,000,000

Consumer Information Center: $1,540,000

National Science Foundation: $2,337,000,000

National Institute of Building Sciences: $250,000

Fiscal 1991 appropriations for Foreign Operations inched up by 1.69 percent over 1990 levels, but were 10.46 percent higher than 1989 appropriated levels.

Even though last year saw discussions in both the Administration and Congress about the failures of U.S. foreign aid, appropriations are up again for 1991. This is due in part to a desire to help the emerging Eastern European and Central American democracies. The U.S. agreed, for example, to contribute $70 million to a new development bank for Eastern Europe despite the failures of similar institutions such as the World Bank and the Inter-American Development Bank.

Multilateral Aid: $1.95 billion

Examples: Inter-American Development Bank: $78,000,000

Inter-American Investment Corporation: $13,000,000

World Bank: $50,000,000

International Development Association: $1.06 billion

Asian Development Fund: $243,900,000

African Development Fund: $105,452,000

European Development Bank: $70,021,000

Bilateral Aid: $7.7 billion

Examples: Agricultural Aid: $491,635,000

Private Sector, Energy, Selected Development Aid: $152,223,000

Sub-Saharan African Development Aid: $800,000,000

Agency for International Development (AID) Operating Expenses: $435,000,000

Economic Support Fund: $3.46 billion

Anglo-Irish Accord: $20,000,000

Multilateral Assistance Initiative:
Philippines: $160,000,000
Eastern Europe: $418,675,000

Other:Export-Import Bank: $785,000,000

Trade and Development Program: $35,000,000

Overseas Private Investment Corporation:

Direct Loan Limitation: $40,000,000

Guaranteed Loan Limitation: $250,000,000

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Reading File

PMMR Professional Medical Manufacturers Representatives, Inc.

2 Brown Rd.
Corning, N.Y. 14830

607-962-8627

~~JUL 1 1996~~

AUG 1 1996

7/23/90

B. Ward

Dear Ms Green,

Please advise President Bush that I, and a number of my business associates (a list will be furnished upon request) are STOPING our FINANCIAL Support of The Republican Party UNTILL we can See major STEPS being taken to reduce the Government waste uncovered by your own General Accounting office.

That financial Support is Going to Citizens AGAINST Government WASTE, AND TALK of TAX INCreases in Light of WHAT is being wasted is A INDICATOR of The LACK of

This ADMINISTRATIONS UNDERSTANDING of just how upset we are with the "TAX 'em" mentality.

Sincerely, John Slater

COUNCIL FOR
CITIZENS AG
GOVE

From the desk of
George Bush

1301 Connec

THE CHIEF of STAFF has seen

PHOTOCOPY GB HANDWRITING

J. S.
F.Y.I.

Alan L. Keyes
President

Mr. John A. Slater
2 Brown Rd
Corning, NY 14830

Dear Mr. Slater:

With your letter to your Cong. [illegible] have helped to capture the attention of Congress as seldom before.

Peter Grace and I want to thank you very much for taking the time to sign and mail your letter to your Congressman and for your very generous contribution.

I want you to know that right now we have embarked on an aggressive program to follow-up on your letter demanding an end to the $180 billion of waste found by Congress' own investigating agency, the General Accounting Office (GAO).

I only wish you could have been here in the national headquarters to hear some of the reactions from the Congressmen. The big spenders are howling! Now they are attacking the report and the numbers of their own agency! But the conclusions in the GAO report are no different than those found by the Grace Commission and many Inspector Generals throughout the government.

Let me assure you that we are not going to let the big spenders disregard or dismiss GAO's blockbuster report of $180 billion in government waste. Your letter was the first critical shot in this new war on waste, new taxes and the deficit. With such help as you have just given us the issue of waste is not going away. It is going to get bigger and bigger until it overwhelms those politicians who are recklessly endangering our financial security with their wasteful deficit spending.

I also want you to know that our supporters on Capitol Hill are energized by this truly incredible outpouring of success. This is exactly the type of support they so desperately needed.

I will be writing you as we take the next steps to accelerate our battle and take advantage of this once in a lifetime opportunity to eliminate the deficit-producing waste. Again, on behalf of Peter, our supporters in Congress and the dedicated staff at CCAGW, thank you very much for sending your letter and your generous contribution.

Sincerely,

Alan Keyes

THE WHITE HOUSE
WASHINGTON

July 18, 1990

Dear Mr. Slater:

Thank you for your message to President Bush expressing your concern about waste in government. Your thoughts and views are greatly appreciated.

President Bush is committed to ensuring the integrity of expenditures of public funds and has made it a priority for his Administration to put a stop to any waste or mismanagement in the way government does business. By maintaining tighter control and higher standards in the procurement and use of goods and services, the Administration will be better able to eliminate wasteful Federal spending. The President has called his commitment to eliminating government waste his "bond" with the American people.

If you are aware of specific instances of possible waste or fraud in the use of Federal funds or property, please report them directly to the Inspector General of the appropriate U.S. Government department or agency. The President has appointed these Inspectors General to fully investigate, in complete confidence, any such allegations. Almost all of them have toll-free, hot-line telephone numbers listed in the telephone directory under United States Government.

With the President's best wishes,

Sincerely,

Shirley M. Green

Shirley M. Green
Special Assistant to the President
for Presidential Messages
and Correspondence

Mr. John A. Slater
PMMR, Inc.
2 Brown Road
Corning, NY 14830

LOOK AT THE General Accounting office report! THAT Good enough for STARTERS!

PMMR, INC.
2 Brown Road
Corning, N.Y. 14830

ELMIRA, NY 149
PM 1
24 JUL
1990

The White House
Shirley M Green Special asst to the Pres.
1600 Pennsylvania Ave
Washington, D.C. 20001

The Heritage Foundation Backgrounder

No. 779

The Heritage Foundation 214 Massachusetts Avenue N.E. Washington, D.C. 20002 (202) 546-4400

The Thomas A. Roe Institute for Economic Policy Studies

July 23, 1990

ELEVEN CONDITIONS FOR A BUDGET SUMMIT

Daniel J. Mitchell
John M. Olin Fellow

INTRODUCTION

If the current White House-Capitol Hill budget negotiations follow the pattern established by previous summits, the result will not be a balanced budget. It will be higher taxes, more spending, and a larger deficit. This is made all the more likely because of George Bush's recent assertion that "tax revenue increases" must be part of any summit agreement – a deplorable flip-flop which simply relieves the pressure on Congress to control runaway spending.

Compounding Bush's strategic blunder, the Administration also has failed to frame properly the fiscal debate to give budget negotiators a clear picture of what specific items must and must not be included in an acceptable deficit reduction agreement. Not only has the Administration failed to list specific components of an agreement, the White House repudiated Senate Minority Leader Robert Dole's comment that the President would not accept an increase in personal income tax rates.

Tough Safeguards. If there is an acceptable agreement, it will need glue to hold it together. This must be budget process reform. Such reform is the equivalent of what verification and compliance guarantees are for international arms treaties. The wide disparity between the promises of budget agreements and the reality of budget outcomes shows that verification and compliance mechanisms are necessary for any domestic summit "treaty."

Without powerful safeguards to make a budget pact enforceable on Congress, it will not be worth the paper it is written on. Unless such safeguards are in the pact, in the form of tough budget control procedures, including a repeal of the current services budget, creation of a second sequester, and a line-item veto, Bush should declare it in principle unacceptable, and lawmakers genuinely concerned about deficit control should not accept it.

As a result of Bush's political blunders, the current budget summit could well become a replay of the mistitled Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). Best known for the infamous and unfulfilled promise of "three dollars of spending cuts for every dollar of taxes," the legislation actually resulted in higher taxes, more spending, and a larger deficit. It is well known that Ronald Reagan personally regards TEFRA as one of his most serious mistakes while President. Unless Bush demands and gets budget process reform, his grand Budget Compromise will fare no better than TEFRA. The only question will be, "How much will taxes be raised, and who will pay them," and the deficit will not be brought under control.

A tax increase, meanwhile, likely will spur additional spending rather than deficit reduction. Already Congress is planning tens of billions of dollars in new spending. A tax-and-spend cycle would slow economic growth or even cause a recession. This will result in less government revenue and higher budget deficits.

Alternative Agenda. Rather than watch the accomplishments of the last eight years unravel, fiscally responsible legislators should advance an alternative agenda to fill the leadership vacuum created by the White House. They should insist on a budget agreement that promotes rather than retards economic growth. Such an agreement should include:

1) No new taxes;

2) Elimination of at least ten programs;

3) A spending freeze;

4) A moratorium on new programs

5) A tax limitation/balanced budget amendment

6) A line-item veto for the President;

7) Reform of the current services budget;

8) A second sequester to stop excessive spending;

9) A supermajority requirement for tax increases;

10) Linking taxes to deficit reduction;

11) A Common sense sequester.

LESSONS OF THE PAST

If the history of past budget summits is any indication, the current negotiations will result in higher taxes with little or no deficit reduction. A recent study by the Tax Foundation, a non-partisan research group, on past budget summits demonstrates the desperate need for procedural safeguards. Under the 1982 Tax Equity and Fiscal Responsibility Act (TEFRA), Ronald Reagan accepted a $98 billion tax increase which supporters claimed would reduce the deficit from $128 billion in 1982 to $104 billion in 1983. Spending restraints never materialized, however, and the actual deficit jumped to $208 billion.

Failing to Learn. The Administration apparently failed to learn from TEFRA. In 1984 it was seduced into raising taxes again, this time by $49 billion to lower the deficit from $185 billion in 1984 down to $181 billion in 1985. The actual deficit, after Congress went on a spending spree, rose to $212 billion.

The 1987 budget summit followed this sorry pattern. Reagan acquiesced to a $28 billion tax increase. The deficit, which was supposed to remain at $150 billion, jumped to $155 billion in 1988.

George Bush witnessed these debacles as Vice President. Even so, last year he accepted a $14.2 billion tax bill which was supposed to help lower the deficit from $152 billion in 1989 to $100 billion this year. The actual deficit this year, however, will probably exceed $150 billion.

The track record of budget summits certainly leaves much to be desired. The big problem, of course, is that Congress has never been willing to follow through on promises to restrain spending growth. As a result, changes need to be instituted that would bind legislators to produce what they promise.

A DEFICIT REDUCTION AGENDA

Some policy makers see deficits as the problem, with higher taxes and spending restraints as equally desirable ways to reduce the deficit. This ignores sound economic principles. In reality, spending is the problem; taxes and borrowing are simply alternative ways of taking money out of the pockets of taxpayers, of transferring resources from the productive sector of the economy to the government.

Unless the summiteers recognize this fundamental truth, a budget summit is unlikely to produce good results. If, on the other hand, budget negotiators wish to promote economic growth, they should adopt the following:

Condition #1: No New Taxes

The most important budget goal for responsible lawmakers remains: no new taxes. Higher taxes are not needed. In both nominal and inflation-adjusted dollars, tax revenues are at an all-time high. Federal taxes are expected to consume 19.6 percent of the Gross National Product (GNP) this year – the fourth highest level in peacetime history. Only twice have federal taxes exceeded 20 percent of GNP – in 1969 and 1981; in each case the economy fell into a recession the following year.

Increasing Red Ink. With the U.S. economy already somewhat weak, a tax hike almost certainly would trip the country into a recession. This would increase the deficit substantially. Unemployed Americans do not generate as much tax revenue for the government as those with jobs. Consumers with fewer after-tax dollars can afford fewer goods and services, and have less money to invest. And corporations with fewer sales do not pay as much in taxes as do those earning healthy profits. Even a modest slowdown would mean a great deal of red ink. The Congressional Budget Office (CBO) estimates that the deficit would rise by $52 billion next year if the unemployment rate increased by just one percentage point. The CBO also projects that if real economic growth is just one percentage point lower than projected, the deficit would climb by $26 billion.

A tax increase thus could increase the deficit by reducing economic growth. To make matters worse, a tax hike's revenues surely will not be used to trim the deficit. The political reality of the congressional budget process all but guarantees that a tax increase simply would trigger increases in federal spending. The deficit level is already statutorily determined by the Gramm-Rudman-Hollings Deficit Reduction Act. Higher taxes simply would allow Congress to comply with the deficit target at a higher level of spending.

Condition #2: Eliminate Programs

A necessary condition for a pro-growth budget summit agreement is the termination of federal programs. If there truly is a deficit crisis, as tax-hike supporters contend, then surely some of the more egregious examples of ineffective, wasteful, or pork barrel federal programs should be eliminated entirely. The budget negotiators should, at the very least, target a minimum of ten federal programs for termination to demonstrate that they are serious about trimming spending.

The ten should be chosen from:

Program	**1990 Funding Level**
Amtrak subsidies, which allow middle-class rail passengers to travel inexpensively.	$578.4 million
The National Endowment for the Arts, which gives handouts to artists and often sponsors controversial projects.	$167.5 million

The Legal Services Corporation, which often uses funds for political advocacy rather than to help poor clients.	$306.3 million
Economic Development Administration, which funds state and local pork barrel public works and other projects.	$ 23.7 million
Urban Mass Transportation Administration, which subsidizes forms of public transportation that usually are too costly and inefficient to run on their own.	$3.2 billion
Community Development Block Grants, which passes out funds to local governments.	$3.0 billion
Rural Electrification Administration, an obsolete program since 99 percent of rural residences have electricity.	$31.5 million
Agricultural Subsidies, cash payments, primarily to wealthy farmers.	$6.9 billion
Direct Foreign Aid, welfare for less developed countries.	$11.0 billion
Multilateral International Organizations, which funds organizations such as the United Nations.	$720 million
Low-Income Energy Assistance, which provides subsidies to people living in colder climates.	$1.4 billion
The National Endowment for the Humanities, which subsidizes writers, poets, and scholars.	$159.3 million
Alternative Energy Programs, which subsidize energy production that is too inefficient and costly to be sold to customers.	$138 million
Small Business Administration loans to small enterprises with low credit ratings.	$341.9 million
Appalachian Regional Commission, which subsidizes pork barrel public works projects in thirteen Eastern states.	$108.4 million
Job Training Partnership Act, a failed training program at a time when the mar-	

ket and private firms succeed in this task without public funds.	$4.5 billion
Superconducting Supercollider, an expensive scientific project with little practical application.	$217.8 million
Peace Corps, which provides social workers for less developed countries.	$168.3 million
Agency for International Development – Population Planning, which tries to limit the number of children born in less developed countries.	$34.1 million
Interstate Commerce Commission, an obsolete regulatory agency that restricts business activities, lowering American competitiveness.	$43.7 million
Corporation for Public Broadcasting, which funds T.V. programs aimed at upper class viewers, even though private cable channels provide the same service.	$229.4 million
Job Corps, another failed government jobs program	$767.1 million
Community Services Block Grants, which provides subsidies to local governments.	$390.0 million
Food for Peace Program, which dumps surplus American food into less developed countries, usually inducing local farmers not to produce.	$1.0 billion

Sources: Office of Management and Budget, Congressional Budget Office.

Condition #3: Freeze Spending

In addition to program terminations, budget summiteers should limit total fiscal 1991 spending to the 1990 level. This alone would cut the deficit almost in half in just one year, since tax revenues already are projected to increase by approximately $70 billion next year. Under a freeze, lawmakers would have the option to increase spending for politically sensitive items, such as Social Security Cost Of Living Adjustments (COLAs), but they would have to "pay" for these increases by reducing spending in other areas. If overall spending did not increase, all of the projected increase in tax collections under existing tax rates could be used for deficit reduction.

Some critics maintain that a spending freeze is unrealistic and would harm the economy. Yet between 1986 and 1987 the total growth of federal spending was held to $13.5 billion, an increase of less than 1.4 percent. This virtual freeze in spending resulted in a record $71.5 billion one-year reduction in the deficit. As a result, federal borrowing to cover budget deficits dropped from 5.3 percent of GNP to 3.4 percent in just one year. While old-fashioned economic theories predicted that the economy would contract because of the cutback in government spending, real GNP grew that year at a healthy 3.4 percent rate.

Forcing Choices. Another advantage of a spending freeze is that legislators finally would be forced to choose between different programs and to determine priorities. Under the current budget process, there is scarcely the pretense of priority-setting as higher taxes permit across-the-board increases in almost all programs, regardless of their relative merit.

A spending freeze also should apply to reauthorizations of existing programs, which almost always receive a congressional funding hike. Congress is now considering major reauthorization bills for housing programs, farm programs, and other programs. The participants in the budget summit should agree that spending levels in these bills will be capped at current levels.

Condition #4: A Moratorium on New Programs and Additional Spending

Congress should pledge no new programs until the budget is balanced. To consider an increase in the tax burden while continuing to create new programs and expand existing ones is deficit hypocrisy. Yet that is precisely what Congress has been doing. This is clear from the special interest pork-barrel projects tacked on to the recently-enacted $4.3 billion "Dire Emergency" Supplemental Appropriation which originally was designed to funnel foreign aid to Nicaragua and Panama. Included in this "Dire Emergency" legislation:

- $6 million for a wildlife refuge in Iowa
- $750,000 for a cargo and passenger boat for American Samoa
- $300,000 for a fishery resources study in Wisconsin
- $5 million for the United Nation's Environment Fund
- $6.8 million for grasshopper control
- $10 million in aid for Haiti
- $1 million in travel expenses for the Veterans Administration

Many of the legislators who voted for these special interest projects are the same ones who say the deficit problem is so severe that taxpayers should ante up more of their paychecks.

Congress also has thrown fiscal responsibility to the winds by considering legislation establishing a host of new entitlement programs for such things as child care. Legislators should demonstrate their commitment to deficit reduction by withdrawing the child care bill and other new programs from consideration.

The fact that the budget has been balanced only one year in the past three decades suggests that the budget process is fundamentally flawed. If a budget agreement this year is to mean anything, it must contain a good-faith package of reforms designed to assure Americans that legislators live up to whatever commitment they make to control spending. A litmus test for deficit reducers is whether they support the powerful safeguards needed to turn an agreement into reality. If responsible lawmakers cannot win support for key budget process reforms, they should refuse to support a budget summit deal that can be nothing other than a sham.

Reforming the process admittedly is not a panacea. Congress has shown remarkable creativity when it comes to wiggling out of deficit-reduction deals. But a better process would lead to better decisions. And certain major reforms would limit the wiggle room. The essential reforms:

Condition #5: Tax Limitation/Balanced Budget Amendment

The recent rejection of a balanced budget amendment by the House of Representatives clearly illustrates that Congress is more interested in taxing and spending than in fiscal responsibility. Yet a tax limitation/balanced budget amendment is precisely what is needed to restore balance to the budget process.

Politicians have an incentive to spend money since the beneficiaries of federal largesse tend to be concentrated, politically active, and able to reward politicians with votes, contributions, and other types of support. The victims of federal spending, by contrast, are ordinary workers and other taxpayers who are unlikely to calculate the costs imposed on them due to particular programs. Even if they are aware of how federal spending on various programs burdens them, they are unlikely to be in a position to counter the politically-sophisticated and well-financed lobbying efforts of the special interests who benefit from federal spending. A tax limitation/balanced budget amendment would force lawmakers to take into account the interests of the general public by limiting the amount of resources politicians could extract from the productive section of the economy.

Condition #6: A Line-Item Veto

Powerful legislators often attach pork barrel projects and special interest spending to larger, unrelated pieces of legislation knowing that the President may be reluctant to veto the underlying bill. This practice adds billions of dollars of wasteful spending to the budget. Some 43 state governors have line-item veto authority. This has achieved major savings at the state level. A President with line-item veto power, which would allow him to cross out irrelevant sections of legislation without rejecting the entire bill, could cut deficit spending by billions of dollars.

Condition #7: Current Services Budget Reform

One of the biggest obstacles to sound fiscal policy is the political manipulation of budget numbers. The federal government uses a budget device known as the "current services budget." This automatically assumes that federal spending will increase in future years according to the expected inflation rate, projected increases in program beneficiaries, and program expansions already built into the law. Such assumed increases are not, officially, treated as spending increases. Thus if spending for any particular program did not increase as fast as the current services budget estimates, this is treated as a "budget cut." In fact, of course, this is a spending increase. This through-the-looking-glass re-definition of a budget cut has significant political consequences, since special interest groups can build public opposition to fiscally responsible spending limitation measures by painting them as severe cutbacks when, actually, outlays have increased – though not at the rate originally presumed. Ten years of newspaper stories and news reports about "cruel and draconian" budget cuts have convinced many Americans that spending actually has been "cut to the bone." In reality, federal spending has more than doubled since 1980. The only thing that has been cut is the rate of increase. Responsible budget making thus requires that the gimmick of the "current services budget" be scrapped and replaced with a budget process that honestly measures changes in annual spending.

Condition #8: A Second Sequester

One of the few bright spots in budget policy is the 1985 Gramm-Rudman-Hollings Deficit Reduction Act. Adjusted for inflation, federal spending is growing less than half as fast now as it was before the law's enactment. The key to Gramm-Rudman-Hollings is the automatic spending control mechanism known as sequestration. Under sequestration, if Congress tries to spend more than Gramm-Rudman-Hollings allows, spending levels are automatically reduced by the amount needed to lower the deficit to the legally required level. A loophole in the law, however, is that the sequester takes place on October 15, barely two weeks into the fiscal year. Beginning October 16, Congress can add additional spending without the fear of sequestration. A budget agreement can close this loophole by adding a second sequester to Gramm-Rudman which would occur in the middle of the fiscal year. Congress would then have a choice either to forego back door spending or run the risk of sequestration.

Condition #9: Supermajority Tax Increase Vote

In addition to the sequester, Gramm-Rudman has tightened the budget process by requiring 60 votes before the Senate can consider legislation that would increase the deficit. This provision should be strengthened by a similar, supermajority requirement for any tax increase.

Condition #10: Taxes Dedicated to Deficit Reduction

Higher taxes are not needed and would damage the economy. So lawmakers should not support any tax increase proposed by the summiteers. If a tax increase appears inevitable, however, Congress should mandate that revenues be used for deficit reduction.

Under current law, any tax increase almost surely will lead to a dollar-for-dollar increase in federal spending. The reason for this is that Gramm-Rudman-Hollings limits total spending to the sum of projected tax revenues plus the allowable deficit target. The 1991 deficit target, for instance, is $64 billion. This target will not change if taxes are raised by, say, $20 billion. All that changes is that Congress can now meet that target at a higher level of overall spending. The actual deficit, in other words, remains that set by the Gramm-Rudman-Hollings law. Raising taxes merely permits higher spending.

The summiteers supporting a tax increase claim, of course, that a tax hike would be used for deficit reduction anyway and so it is not necessary to reform the budget process. Previous experience suggests, however, that this is like the kleptomaniac assuring the store manager that security guards are unnecessary. If lawmakers truly intend to use new taxes only for deficit reduction, they should not be reluctant to support a requirement to ensure that is actually what happens.

The only way to ensure that higher taxes do not get spent is to tie taxes to automatic reductions in the Gramm-Rudman-Hollings deficit target. Under this proposal a $20 billion tax increase would reduce the Gramm-Rudman-Hollings deficit target by $20 billion – in 1991 that means it would be reduced from $64 billion to $44 billion. Even if the Gramm-Rudman 1991 deficit target were to be moved to $100 billion, a $20 billion tax increase would drop the target to $80 billion. Only an undertaking of this kind, built into budget law, would assure what the summiteers profess to desire – a rise in taxes to cut the deficit.

Condition #11: A "Common Sense" Sequester

Many analysts believe that the White House is capitulating on taxes, not because the President really believes in a tax increase, but because he has no choice. According to this thesis, if the President were to stick to his promise, and Congress refused to exercise the fiscal restraint needed to meet the Gramm-Rudman-Hollings deficit target, the stalemate would mean a sequester. Failure to control this year's spending, combined with a relatively sluggish economy, means that the potential 1991 sequester could be in the $50 billion-$100 billion range. The assumption is that a sequester of this magnitude is unacceptable, especially since the defense budget must bear 50 percent of the total sequester.

The probable reason why a sequester is so unpalatable to the Administration is that there is relatively little managerial discretion available under Gramm-Rudman-Hollings. With total federal spending next year expected to approach $1.3 trillion, a cut of $50 billion or even $100 billion is hardly draconian. The rigid formula which determines how a sequester is applied, however, makes sequestration extremely painful politically. But if Congress were to allow the Administration even a modest amount of authority to manage the sequester, shielding some programs and subjecting less important parts of the budget to a larger percentage of the total cut, sequestration would become much more acceptable.

CONCLUSION

Budget summits historically have resulted in higher spending, more taxes, and bigger deficits. This need not be the case this year. A combination of no new taxes, program terminations, a cap on overall spending, locked in with real budget process reform, would reduce deficit spending dramatically.

Avoiding Bad Policies. The White House so far has allowed the budget summit to evolve into a tax summit. Before bad discussions are allowed to become bad policies, fiscally responsible participants in the summit process should insist on a pro-growth agenda for the negotiations. Smart politics, as well as sound economics, dictates that these positive proposals must be part of any final agreement. Should Congress refuse to accept such a package, the sequester can be utilized to achieve real deficit reduction. And even as currently structured, sequestration would be a preferable alternative to a repeat of the 1982 TEFRA tax hike debacle.

ECONOMIC TALKING POINTS
Republican Policy Committee **8/17/90**

August is the 93rd month of a record-setting peacetime economic expansion.

- **Real GNP** grew a modest 1.2% in the 2nd quarter of 1990. Growth in the 1st quarter was 1.7% (revised down 0.2 points). The news was particularly unpleasant because growth in the 2nd quarter only occurred in government purchases and business inventories. While some inventory buildup is normal, it is not sustainable. Unacceptably high inventory levels can lead to layoffs and production cutbacks that would slow the economy down. The international trade picture dimmed slightly in the 2nd quarter, too, with import growth exceeding export growth. Real GNP in the 2nd quarter of 1990 stood at $4.16 trillion (1982 dollars, annual rate), or $12.6 billion higher than in the 1st quarter figure. [*Commerce Dept.*]
- Real GNP figures for 1987-89 have been revised. For 1989, real GNP grew at a 2.5% pace (instead of the 3.0% reported earlier). Wages and salaries were revised downward by some $58 billion, accounting for most of the adjustment. (This significant income revision explains in part the Federal revenue shortfall recently projected by OMB.) [*Commerce Dept.*]
- The civilian **unemployment rate** jumped 0.3 points to 5.5% in July, its highest level in 2 years. This big rise resulted from the loss of 219,000 jobs. Most of the loss came from the termination of 160,000 temporary Census jobs. The private sector payrolls were down 45,000 — primarily in manufacturing and construction, 2 sectors that have been weak all year. [*Labor Dept.*]
- **Personal Income** grew 0.4% in June to $4.64 billion (annual rate, current dollars). Wages and salaries and rental income showed increases; farm income declined due to a drop in government subsidies. Note: Personal income statistics for 1987-89 were revised downward recently. The1989 figures were pared back $43 billion. [*Commerce Dept.*]
- **Consumer spending** jumped a robust 1.0% in June following no change in May. In dollar terms, the increase amounts to $34.5 billion, and brings total consumer spending to $3.64 trillion (seasonally adjusted annual rate, current dollars). This is the first sizeable increase in spending since January. [*Commerce Dept.*]
- The **personal saving rate** was 5.1% in May, continuing the trend of higher saving rates in 1990 compared to recent years. Personal saving for the month of June was $193.6 billion (seasonally adjusted annual rate). That is a $16 billion decrease from May, due to the large increase in consumer spending in June. [*Commerce Dept.*]
- Inflation perked up a bit in June after easing in the spring. The **consumer price index** (CPI-U) rose 0.4% in July, after a 0.5% rise in June. These price increases do not yet reflect the effects of the "spike" in oil prices stemming from the Iraq situation. Over the first 7 months of 1990, the CPI has risen at a 5.8% annual rate, higher than the 4.6% recorded for 1989. On a brighter note, the **producer price index** (PPI) fell 0.1% in July after a modest rise of 0.2% in June. [*Labor Dept.*]
- The **index of leading economic indicators** was unchanged in June, on the heels of a big gain of 0.7% in May. Among the index's 11 components, only 4 were positive, 6 were negative, and 1 was unchanged. Positive signals were recorded by prices of sensitive materials, stock prices, building permits, and business deliveries. Among the components recording negative moves were manufacturers' unfilled orders, orders of consumer goods, the money supply, and consumer confidence. [*Commerce Dept.*]

- The **industrial production index** was unchanged in July at 109.8% (1987=100). Excluding cutbacks in durable goods production (autos in particular), the index would have risen 0.2%. **Capacity utilization** declined by 0.2 points in July, to 83.4% of "full capacity." [*Federal Reserve*]
- **Productivity** — output per hour worked — rose 1.9% in the 2nd quarter of 1990 (seasonally adjusted annual rate). This encouraging increase follows 3 consecutive quarters of declines (based on revised data). Durable manufacturing productivity shot up a remarkable 6.7% in the 2nd quarter. [*Labor Dept.*]
- **Business inventories** fell 0.4% in June. Total manufacturers' and trade inventories stood at $797.3 billion (seasonally adjusted). This contraction was encouraging because many analysts were concerned about the larger-than-desired inventory buildup in May. [*Commerce Dept.*]
- **Orders for durable goods** fell 3.2% to $124.7 billion in June (seasonally adjusted). Half of this steep decline is attributed to the scale-back of defense capital goods. Weakness was registered across the manufacturing sector. [*Commerce Dept.*]
- **Corporate profits** were up 1.1% to $289.7 billion in the 1st quarter of 1990. While modest, this gain is welcome news after 3 consecutive quarters of decline. [*Commerce Dept.*]
- **Construction spending** was flat in June, at $447.5 billion (seasonally adjusted annual rate). In the previous 2 months, spending had fallen. Higher interest rates and tighter lending requirements (the so-called "credit crunch") have contributed to the slowdown. However, construction spending is still 3.7%, or $15.9 billion, higher than it was 12 months ago. [*Commerce Dept.*]
- **Housing starts** fell 2.6% in July, to 1.15 million (seasonally adjusted annual rate). It was the 6th monthly decline in a row. The current level of housing starts is the lowest since the 1981-82 recession. [*Commerce Dept.*]
- **Retail sales** rose just 0.1% in July to $149.5 billion. This sluggish performance follows a sharp 1.1% jump in sales in June (revised). Over the last 12 months, retail sales grew just 2.8% — far lower than inflation. Much of the sluggish retail performance is concentrated in auto sales. Excluding autos, retail sales grew 0.3% in July and 4.6% in the last 12 months. [*Commerce Dept.*]
- **Interest rates** moved erratically in early August because of economic and political uncertainties, especially stemming from tensions in the Middle East. Interest rates initially fell in July, in response to a drop in the Federal funds rate. But they ticked back up on inflation news and inflation fears of whether the Federal Reserve may have loosened monetary policy too much. The outcome of the budget summit also contributed to interest rate uncertainties. The early August yield on 3-month Treasury bills was about 7.7%; on 30-year Treasury bonds, about 8.8%. Analysts still expect rates to fall slightly in the months ahead. [*Federal Reserve and Treasury Dept.*]
- The **merchandise trade deficit** plummeted 34.7% to $5.07 billion in June. This is the smallest deficit since December 1983. While the report is great news, it precedes the Mideast outbreak and its rapid rise in oil prices. That "price shock" will probably make the deficit widen somewhat beginning with the August data, which will be released in about 2 months. [*Commerce Dept.*]

Contact: Dale Jahr, 224-2946

U.S. Senate Republican Policy Committee

William L. Armstrong, *Chairman* August 17, 1990

ECONOMIC TALKING POINTS

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Summary: Sluggish performance can be expected in the months ahead. Job and income growth in 1990 are not keeping pace with the past couple years. Consumer spending is slow. Government purchases are not a likely source of growth. Investment has been weakened by modest gains in corporate profits. Exports are growing, but only slowly. The "spike" in oil prices portends higher inflation than expected. The cautionary signals in the economy are pointing to the need for sound Republican economic policies geared for growth and opportunity.

Contact: Dale Jahr 224-2946

Executives' Investment Reactions to Tax Proposals Affecting Savings & Investment

A Securities Industry Association Research Report Based on a Survey Conducted by Opinion Research Corporation

July 1990

U.S. Chamber of Commerce

Washington, D.C. 20062

THE CHIEF of STAFF has seen

September 7, 1990

TO: Members of the Budget Summit

The associations and companies listed below wish to re-emphasize their strong opposition to efforts to increase motor fuel taxes for deficit reduction. The current world situation clearly demonstrates the need to invest in improving the efficiency of the U.S. transportation infrastructure network. Now more than ever, we need to preserve the commitment to a public-private partnership for improving transportation productivity based on the concept of user fee financed federal transportation trust funds for highway and transit programs.

To a large degree, surface transportation programs have been successful because the public and business communities have supported a financing approach that matched benefits with the payment of motor fuel user fees. Removing the connection between the user fee financing approach and transportation improvement programs will destroy the nation's confidence in this method of meeting our transportation needs. With surface transportation needs growing at an alarming rate, sufficient investment in our infrastructure must be made to support the level of service Americans demand and our economy needs to compete in a global marketplace. A motor fuel tax increase for deficit reduction will undo the fairest and most effective method of funding federal surface transportation programs.

We urge you to oppose the use of federal motor fuel taxes to reduce the deficit. Breaking faith with highway users by raising the motor fuel tax for non-transportation purposes is the wrong means to achieve the end of deficit reduction.

American Consulting Engineers Council
American Petroleum Institute
American Road and Transportation Builders Association
Asphalt Institute
Associated Builders and Contractors
Associated Equipment Distributors
Associated General Contractors
Construction Industry Manufacturers Association
Highway Users Federation
National Aggregates Association
National Ready Mixed Concrete Association
National Stone Association
Parsons, Brinckerhoff, Quade & Douglas, Inc.
Portland Cement Association
Vulcan Materials Company

National Stone Association
1415 Elliot Place, N.W.
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Washington, DC 20500

THE WHITE HOUSE

WASHINGTON

August 14, 1990

MEMORANDUM FOR KEY POLITICAL CONTACTS

FROM: DAVID M. CARNEY
SPECIAL ASSISTANT TO THE PRESIDENT AND
DIRECTOR, OFFICE OF POLITICAL AFFAIRS

SUBJECT: BUDGET SUMMIT UPDATE

In our continuing effort to provide you with current information we are sending you this information on the progress of the budget summit as outlined by the President during a press briefing on August 14.

The enclosed information outlines three basic points:

1. The President has provided the necessary leadership to bring together Congressional Democrats to deal with this critical issue.

2. After almost 100 days the Democrat Congress went on August recess without proposing a single item to reduce the $100 billion federal deficit.

3. In fact, not only has Congress failed to provide a single idea to solve this huge deficit, they recently passed additional spending bills which were billions of dollars <u>above and beyond</u> the President's original request.

Clearly this issue should be put forward to the American public.

We thank you for your effort.

THE WHITE HOUSE

WASHINGTON

Excerpts from President Bush's August 14, 1990 News Conference on the Budget

"Our current budget or lack thereof constitutes a real threat to the economic well-being of our country. And in this case, the problem is a lack of action on the part of the Congress -- an abdication of responsibility that endangers our economic vitality and the jobs that go with it."

"I took the initiative in May in calling on the Democratic Congressional leaders to join me in a bipartisan summit on the budget."

"When the Democrats sought to hold the talks hostage over new revenues, I made the very difficult decision to put everything, including taxes, on the table to make those budget talks succeed."

"The Administration refrained from divisive rhetoric, worked in earnest, held meeting after meeting, without any preconditions ... We offered billions in additional spending cuts even as Congressional committees were voting out spending bills that would bust the budget."

"On July 26, both sides agreed to put budget plans on the table. We again had a complete proposal ready for negotiation. After weeks of good faith negotiating, we expected a specific Democratic plan in exchange."

"While the summit failed to move forward with specific solutions the Congress continued with counterproductive legislation. For example, the House has already passed ten appropriations bills, eight of which exceed my request for discretionary spending by $14 billion -- and are $25 billion higher than the budget for last year."

"And the Senate is asking that the taxpayer now pay up to $150 million to finance their election campaigns. I oppose asking the public to pay for the re-election of Members of Congress, and I will veto any such bill that appears on my desk."

"Congress now has gone on recess. And 100 days after I called on the Democrats and Republicans in the Congress to work with me toward a bipartisan budget solution ... the Democrats have yet to offer one single proposal at the budget summit."

"I stand ready to work on this process as long as it takes to get a 5 year package which solves the problem. I have postponed what I think was a very important September trip to Latin America to focus on this issue."

"There are, however, a number of specific realities to be noted:

-- First, the Congress has the responsibility to pass a budget. But make no mistake: I will use that pen to veto <u>any</u> and <u>every</u> spending bill that busts the budget.

-- Second, if no budget agreement is reached, that means a sequester on October 1 of about $100 billion. As painful as such deep cuts would be, I'm determined to manage them the best I can, knowing I've done all in my power to avoid them. So, the Democrats in Congress should know that if it comes to sequester, they will bear a heavy responsibility for the consequences."

-- Third, if the Congress really wants economic growth <u>and</u> increased government revenues, the place to start is <u>not</u> with tax increases, but with incentives for growth, investment and jobs -- I cite the capital gains area as one that would stimulate and be investment oriented.

-- Fourth, Congress must recognize the utter failure of their budget process to control spending. It must be reformed.

-- Fifth, our budget must maintain a defense posture consistent with the demands on American leadership in the world and the dangers we face.

-- And finally, the Democratic leadership of Congress must understand that the American <u>people</u> expect them to do their job -- to come forward with concrete proposals to cut the deficit. Our nation's fiscal problems are vitally important to America's future, and all of us have an obligation to address them."