Policy Analysis

Cato Institute Policy Analysis No. 182: Crime of the Century: The 1990 Budget Deal After Two Years

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Executive Summary

Two years ago this October, George Bush officially renounced his "no new taxes" pledge and signed into law the 1990 budget pact. Widely acclaimed as "the deal of the century," that single act has caused the most rapid deterioration in the nation's fiscal health in this century. It may also very well cost Bush the presidency in November.

At the Republican convention in Houston, Bush finally conceded that the budget deal was a mistake. Yet the conventional wisdom inside Washington is still that the budget deal was a fiscal triumph. Many of the original architects of the deal--Office of Management and Budget director Richard Darman; House Budget Committee chairman Leon Panetta; Senate majority leader George Mitchell; and Sen. Pete Domenici, the ranking Republican on the Budget Committee--insist that it has placed airtight lids on federal spending.[1] They also claim that the current deficit would be at least $50 billion a year higher without the pact.[2]

The reality is that after two years of the budget deal, the federal fiscal situation has worsened in every measurable way. Not a single benefit promised by the 1990 budget deal has been delivered.

The 1991 budget deficit was supposed to have been $253 billion. Instead, it was $269 billion. The 1992 deficit was supposed to be $262 billion. Instead, it will be $314 billion. In 1990, the year before the budget agreement took effect, the deficit was only $152 billion.

The budget deal was supposed to save $500 billion over five years. When the budget deal was passed, the 1991-95 deficit was projected at $770 billion. The latest Congressional Budget Office estimates place the five-year deficit at $1.426 trillion. The budget deal added at least $500 billion to the national debt; it did not reduce the debt by that amount.

The budget deficit from 1991 through 1995 will be $1.3 trillion higher than it would have been if Congress had simply remained on the Gramm-Rudman-Hollings track and had never held a budget summit.

Government expenditures have not been cut as promised. They have accelerated at a faster pace than at any time in 30 years. Since the budget deal, the domestic budget has grown by $118 billion, or almost 20 percent above inflation. This year alone, real domestic expenditures will climb by 11 percent.

The 1990 budget deal was supposed to be a boon to the economy. Since October 1990, when the economy was hit with the new $165 billion tax hike, the largest tax increase in American history,[3] America has lost more than 100,000 jobs and the unemployment rate has climbed from 5.5 to 7.4 percent. After two years of the budget deal, real disposable

personal income has actually fallen slightly.[4] Stagnation has been the market response to the 1990 Budget Act.

It is said that those who ignore the mistakes of history are doomed to repeat them. Budget summits are now known to be dangerous to America's economic health. The 1990 budget deal is the third major bipartisan budget agreement since 1982 to end in higher taxes, higher spending, and deeper debt.[5]

Nevertheless, many prominent business leaders and politicians are urging yet another bipartisan budget agreement in 1993 or 1994. Clinton's and Bush's advisers have hinted that they would be eager to participate in negotiations to produce an even more grandiose package than the 1990 pact. That would, of course, mean even higher taxes. The unmistakable lesson of the 1990 budget agreement is that progress on the deficit can only be achieved through serious restraint of the growth rate of federal expenditures, not through another fraudulent budget summit.

The Grand Promises of the 1990 Budget Deal

At the time of its passage, Bush and the supporters of the celebrated 1990 budget agreement promised three benefits. First and most important, they argued that the agreement would slash federal borrowing needs by $500 billion through 1995. Both the CBO and the OMB reported that, if strictly enforced, the budget deal would produce a balanced budget by the mid-1990s.[6]

Second, the budget agreement was alleged to be a good deal for taxpayers because it required major reductions in federal expenditures. Indeed, then White House Chief of Staff John Sununu maintained that the package would chop federal spending from 24 percent of GDP in 1990 to under 20 percent of GDP by 1995. Furthermore, the budget agreement contained a new set of annual expenditure caps that were designed to make it extremely difficult for Congress to create new spending programs, particularly for entitlements. Any new spending would have to be offset be an equivalent reduction elsewhere in the budget. In short, the 1990 budget package was typically portrayed as an austerity budget.

Finally, proponents of the package argued that it would stimulate the economy. When he signed the bill, George Bush predicted that the agreement would be a major step toward "restoring confidence in the financial markets." Most conventional Washington economists--normally skeptical of the Bush administration's economic predictions--were in thorough agreement on that score. Financial analysts on Wall Street and economists in Washington recited their standard gospel: a substantial decline in the deficit would generate lower interest rates (because there would be less demand for credit), restore consumer confidence, increase investment, and eventually create a more prosperous and stable economy.[7] That viewpoint was reinforced by assurances from Bush's chief economic adviser Michael Boskin and Federal Reserve Board chairman Alan Greenspan that passage of the budget deal would prompt the Fed to lower the discount rate--an action that often leads to a general decline in interest rates.[8]

The Impact of the Budget Agreement on the Deficit

Table 1
How the 1990 Budget Deal Added to the Deficit

	Federal Budget Deficit (Billions of Dollars)						
	1990	1991	1992	1993	1994	1995	1991-95
Gramm-Rudman baseline	152	64	28	0	0	0	92
Budget deal projected(a)	152	253	262	170	56	29	770
Budget deal actual(b)	152	269	314	331	268	244	1,428

a Congressional Budget Office, December 1990.

b Congressional Budget Office, August 1992.

When the budget deal was being debated two years ago on Capitol Hill, House Republican opponents, such as Dick Armey of Texas, urged its defeat by charging that it would have only a negligible effect on federal red ink. Those critics have been proved wrong. The budget deal has had a dramatic and immediate impact on the federal deficit: it has soared to new heights.

Six weeks after the budget deal was signed into law, the CBO issued a report on the expected deficit from 1991 to 1995. It predicted that the deficit would be $253 billion in 1991, $262 billion in 1992, and $170 billion in 1993. Table 1 shows that the budget agreement did not yield a 1991 deficit of $253 billion; it produced a deficit of $265 billion--a new record. And that was good news compared to the gloomy long-term forecast for the 1992-95 period.[9] In August 1992 the CBO conceded that the deficit for 1992 will be $314 billion and that in 1993 the deficit will not be $170 billion; it will be almost twice that high at $331 billion.

The Gramm-Rudman-Hollings deficit reduction law, which Congress scrapped in favor of the 1990 Budget Act, had mandated a balanced budget in 1993. The 1990 budget deal promised a five-year deficit (1991-95) no worse than $770 billion. But the CBO now acknowledges the five-year deficit will be closer to twice that amount, or $1.43 trillion. In short, the highly touted 1990 budget deal is generating the nation's worst five-year fiscal performance ever.

Curiously, the surge of red ink in 1991 and 1992 has not been condemned as voodoo economics nor as the precursor to economic ruin, as happened during the 1980s after the Reagan administration cut taxes. All of the analysts who predicted financial collapse in the 1980s unless the deficit were reduced immediately have accepted stratospheric deficits in the wake of the 1990 tax hike with indifference.[10] "Apparently there are two kinds of deficits," derisively concluded former Reagan administration economist Paul Craig Roberts last year. "Reagan deficits deindustrialize America, force up interest rates, doom future generations, and suck up the world's savings. But Bush deficits, resulting from the old routine of taxing, regulating and spending, cause hardly a ripple in the domestic or world economy."[11] In fact, as the recession worsened at the start of 1992, more than 100 prominent economists, many of whom supported the budget deal, urged another $50 billion in deficit spending to reenergize the economy.[12]

Budgeting in Wonderland

What happened to the highly acclaimed $500 billion in savings that the 1990 budget deal promised? Several official excuses are offered for the steady rise in red ink since the budget deal passed: the unexpectedly high cost of the savings-and-loan bailout, the Persian Gulf War, explo sive costs in the Medicaid program, a worse than expected economic downturn, the debt hangover from the 1980s, and the slowing of the global economy.

All of those factors have clearly contributed to higher deficits, but the central fact that the $500 billion deficit reduction number was fictitious from the start has been ignored. The budget negotiators, wrote Martin Feldstein in the Wall Street Journal, "surpassed all previous achievements in the art of fanciful budget accounting."[13] For instance, the budget deal purported to "save" billions of dollars by simply moving programs, such as the U.S. Postal Service, off budget. In other words, the expenditures would still be made by the Treasury, but now they would be invisible to the taxpayers. The deal also "saved" nearly $3 billion by converting government direct loans for housing and electric utilities to guaranteed loans. Guaranteed loans do not require an immediate federal outlay; instead, they represent a huge liability. That simply shifts the cost of the program to a later period, when many of the loans go sour.

By far the biggest charade of all was the budgetary treatment of the savings-and-loan bailout.[14] The key to that accounting gimmick was the timing of the government's purchase and sale of insolvent thrift institutions. In 1991, as the government purchased dozens of failed thrifts, the S&L crisis cost the federal government more than $100 billion in outlays. But by 1994, when the federal government began selling the properties and other assets acquired from the failed thrifts, the federal government would receive roughly $40 billion in net receipts. The timing of the acquisition and sale of the S&L assets to coincide with the years of the budget agreement created the illusion that the deficit would be coming down rapidly. Fully $145 billion of the reduction in the deficit achieved from 1991 through 1995 was simply a result of the purchase and sale of the S&L assets.

But the S&L accounting sleight of hand did not end there. The sale of the S&L assets contributed to the fantasy that government spending would be significantly curtailed by the budget agreement. The reason was that the revenues collected from the S&L sales were to be counted as "negative outlays." The $40 billion collected in 1994 and 1995 would be subtracted from the spending totals of the domestic spending ledger, creating the illusion that the budget was being greatly restrained over the five-year period. Whereas the White House and congressional summiteers boasted that federal spending would rise by only $56 billion from 1991 to 1995, in fact, spending absent the S&L bailout would rise by a minimum of $212 billion--even if one accepted the rosy economic assumptions underlying the summit tallies.

Congress relied on other time-honored traditions to make the budget deficit disappear without making meaningful budget reforms or requiring actual spending cuts. A substantial portion of the 1990 budget agreement's reported $500 billion in budget savings, was derived from the rosiest of rosy economic forecasts (see Table 2). The budget summiteers adopted the improbably high average real GDP growth rate for 1991-95 of 3.3 percent; that rate was above the level achieved on average during the Reagan expansion and five times the economic growth rate that the United States had recorded during Bush's first two years in office.[15] If the actual growth rate achieved were just one percentage point lower--which would be closer to the pace of GDP expansion that the blue-chip forecasters were predicting at the time--then the 1995 deficit would be some $140 billion above the summit projection. In fact, thus far GDP growth has been only about one-third of the rate expected. Real GDP grew by -1.2 percent in 1991 and has grown by 2.0 percent so far in 1992.

When Feldstein recently recomputed the budget package numbers using consensus economic forecasts for the 1991 to 1995 period, he found that fully $180 billion of the $500 billion of budget savings vanished. He also predicted that the deficit would rise from $230 billion in 1991 to $305 billion in 1995.[16]

Table 2
Economic Fantasy and the 1990 Budget Act

	1991	1992	1993	1994	1995
Real GDP growth (%)					
Budget deal forecas	1.3	3.8	4.1	3.7	3.5
Actual/current forecast	-1.2	2.0	3.1	2.8	2.6
Unemployment rate (%)					
Budget deal forecast	6.1	6.4	5.6	5.3	5.1
Actual/current forecast	6.7	7.5	6.8	6.1	5.9
Inflation (%)					
Budget deal forecast	4.6	3.4	3.2	3.0	2.8
Actual/current forecast	4.1	2.5	3.0	3.0	3.0
Long-Term interest ratesa (%)					
Budget deal forecast	8.3	7.1	6.1	5.6	5.3
Actual/current forecast	7.9	7.1	6.9	6.9	7.0

Sources: Author's calculations based on CBO, "The Economic and Budget Outlook: Update," August 1992; Joint Economic Committee, "Economic Indicators," August 1992; and Daniel Mitchell, "The Budget Summit Agreement," Heritage Foundation Backgrounder Update, October 1990.

a Ten-year Treasury notes.

Would the Deficit Be Higher without the Budget Deal?

Richard Darman, director of the OMB, and Robert Reischauer, director of the CBO, share the view that regardless of how large the deficit is now growing, it would have been $500 billion higher without the budget deal.[17] In August 1991 the CBO midterm budget report claimed: "The deterioration in the budget outlook does not reflect an erosion of last year's hard-won savings and would have occurred even if the 1990 reconciliation bill had not been enacted. Without the spending cuts and tax increases enacted last year, the situation would be considerably worse."[18] Similarly, the headline of an article by Alan Murray of the Wall Street Journal in July 1991 read, "Last Year's Budget Pact Gains New Admirers for Curbing Spending."[19] Rudolph Penner, former director of the CBO, said last year that "if you look at the fundamentals of the budget, the situation is improving."[20]

The claim that deficits would have been even higher without the 1990 budget deal is a lie that has become part of contemporary Washington mythology. If Congress and the president had forgone the budget summit route and simply allowed the Gramm-Rudman-Hollings automatic across-the-board spending cuts to take effect, the 1991 deficit would have been $64 billion and the five-year deficit would have been roughly $100 billion. True, Congress had a long inglorious track record of missing the deficit targets, by an average of roughly $40 billion per year. Yet even if Congress had rung up deficits twice as high as allowable under GRH, the resulting deficit would still have been half of what it was under the budget agreement in 1991 and 1992. As Figure 1 demonstrates, the 1990 budget agreement produced $1.3 trillion more red ink over five years than would have been permitted under GRH and $658 billion more red ink than originally promised by the budget summit participants.

Figure 1
1991-95 Total Deficits
Billions of Dollars
Gramm-Rudman $92
Budget Deal Projected $770
Budget Deal Actual $1,428
(Graph Omitted)

The Budget Agreement and the Federal Spending Binge

The Budget Act of 1990 did not bring austerity to Washington. In fiscal years 1991 and 1992 real federal spending has grown by more than 10 percent--or more than twice the rate of inflation (see Table 3). Not a single one of the more than 3,000 domestic programs in the federal budget has been terminated as a result of the budget deal and not a single domestic department has seen its total budget decline. Now there is talk in Congress of shifting tens of billions of dollars defense cuts to domestic programs for FY 1993 through FY 1995 so that domestic spending will continue to outpace inflation.

An analysis by economists Gary and Aldona Robbins of Fiscal Associates in Virginia found that the budget deal has led to "$2.74 of new deficit spending for each $1 of new taxes."[21] Using more realistic assumptions, they concluded that each dollar of new taxes will induce roughly six dollars of additional outlays through 1995. So far that has been a highly accurate prediction of actual events.

Table 3
The Mythical Spending Restraint of the 1990 Budget Deal

Fiscal Year	Real 1987 Domestic Spending (Billions of Dollars)	Real Increase
1990	675	
1991	718	6.4
1992 est.	791	10.1
1993 est.	800	1.1

The domestic portion of the budget has been the beneficiary of the new spending spree, not by accident but by intention. The very week that the pact was signed into law, Howard Gleckman of Business Week reported with remarkable prescience that "spending at home is in for a windfall."[22] Gleckman noted: "Notwithstanding all the budgeteers' talk of pain, domestic programs will get an additional $20 billion this year, the biggest increase in years. Everything from Head Start to highways to NASA will enjoy a few more dollars." Similarly, Robert Pear of the New York Times reported, "Even as Congress trims some programs to reduce the federal deficit, it is expanding other programs, and lawmakers acknowledge that savings achieved with great difficulty this year may soon be offset by added spending."[23] The following are among the spending increases chronicled.

A $400 million per year Medicaid expansion.

A $2.3 billion increase in highway spending.

Twenty billion dollars in new money for specific park, land, energy, and water projects. The Senate alone has requested funding for an astounding 2,800 local pork-barrel projects.

Appropriations for 20 public works projects in West Virginia, home of Senate Appropriations Committee chairman Robert C. Byrd, and a half dozen in the Mississippi district of his counterpart in the House of Representatives, Jamie Whitten. Whitten unapologetically boasted of the pork he secured for his constituents, claiming that spending government money is the way Franklin Roosevelt got America out of the Great Depression.

Authorization of a several-million-dollar program to provide "readjustment counseling" for World War II veterans, which prompted Sen. Alan Simpson of Wyoming to derisively note, "It boggles the mind that veterans of World War II, the hideous war that ended 45 years ago, are still having trouble adjusting to civilian life."[24]

A $200 million increase for the Low Income Energy Assistance Program, which pays home heating oil costs of poor Americans, even though energy prices have been falling steeply in recent years.

Tens of billions of dollars in special-interest spending, including a $100,000 project in Idaho to convert vegetable oils into fuel; a $1.7 million bee lab in Texas; a $4 million center for poultry research in Arkansas; $700,000 for a fishing gear entanglement study; $11 million for a navigation project on the Delaware River in New Jersey; $10 million for the Robert C. Byrd scholarship program; $1 million for an Air Force child-care development center in Michigan; $10 million for a parking garage in Ann Arbor, Michigan; and $500,000 for lead paint research.

Particularly indefensible was the unprecedented amount of pork Congress crammed into the 1991 budget for the Interior Department. In surveying the lengthy list of costly special projects included in the appropriations bill for the National Park Service, legislators joked that the agency would soon need to change its name to the "National Pork Service." A December 1990 Washington Post story entitled "Parks, Pork, and Perks" documented the epidemic of special interest spending.

Over the objections of Park Service officials, Congress this year targeted money for dozens of projects and acquisitions that the agency says have little to do with its mission: preserving the nation's natural and cultural heritage. . . .

They include an industrial theme park for Southwestern Pennsylvania memorializing the nation's first aluminum factory, an old railyard in the same state, a historic, four screen movie theater in West Virginia and the birth place of Franklin D. Roosevelt's Secretary of State. All told, Congress approved $271 million in new construction funds for the Park Service, more than 3 times the administration request. . . .

The projects have irritated Park Service officials who say they should not be in the business of local economic development. "It's really a question of the direction of the park service-- whether it concentrates on protecting and making accessible the traditional, crown jewel type parks, or whether it becomes . . . a repository for what are in essence economic development projects," said George Rasley, assistant director for legislative affairs [National Park Service].[25]

In response to the project honoring Cordell Hull, FDR's secretary of state, one indignant park official was quoted as saying: "We do presidents here. We don't do Secretaries of State."[26]

Though members of Congress insisted to their constitu-

ents that the 1990 budget deal would return fiscal sanity to Washington, what they didn't tell them was that the first year of the agreement, at least, awarded most domestic agencies with heftier expenditure increases than at any time since Jimmy Carter sat in the Oval Office. "The new process treats discretionary spending generously," observed former CBO director Rudolph Penner, a supporter of the agreement. "Appropriators for civilian discretionary programs will have more flexibility to increase spending than at any time since the 1970s," he noted prophetically.[27] The final budget totals for 1991 supported his claim. Expenditures for natural resources programs grew by 21 percent, for commerce and housing by 15 percent, and for health by 12 percent in just the first year of the agreement. The chief of staff for the National League of Cities, Frank Shaffroth, boasted to his members, "Every single major program we follow got an increase. That's the first time we've seen that in 10 years."[28]

Congress has not allowed the budget knife to shave its own spending privileges and perks. It approved $375,000 to renovate the House beauty parlor and $2 million for a new restaurant for legislators (at which they would later not pay their bills). More than $25,000 was spent to find just the right location for a gymnasium for House members, and $2.5 million went for new Senate furniture. All told, legislative spending rose by an enormous 11 percent in 1991. In 1992 members of Congress rewarded themselves with a $4,500 pay raise.

How were those huge spending rises permitted at a time when Congress was supposedly cutting the budget? With a few notable exceptions, the media refused to expose the budget increases. "Obsessed with the deficit reduction mission, most of the budgeters and the reporters who covered the story missed the double-digit spending increases in domestic discretionary accounts," wrote Richard E. Cohen of the National Journal. "Whatever the advocates of these programs say in their defense, these hikes seem out of sync with assertions that government must tighten its belt."[29]

The Myth of Entitlement Reform

Richard Darman trumpets the budget agreement as "unprecedented and unique because it reforms a broad range of middle-class entitlement programs." In fact, the budget summit's treatment of entitlements could best be described as benign neglect. The new budget act allows existing entitlements--Medicare, food stamps, and Aid to Families with Dependent Children (AFDC), for example--to run on automatic pilot, expanding without penalty over the 1991-95 time period as more recipients become eligible and as changes in economic conditions raise program costs.[30]

Table 4
Real Entitlement Growth under the 1990 Budget Act

	Spending (Billions of 1992 Dollars)				
	1989	1991	1992	1989-92 Change (%)	1991-92 Change (%)
AFDC	12.37	13.70	14.50	17	6
Child nutrition	7.88	8.57	9.25	17	8
Food Stamps	15.58	19.30	22.72	46	18
Housing Assistance	16.69	17.77	19.44	16	9
Medicaid	39.27	54.27	72.50	85	34
Medicare	96.44	107.94	118.64	23	10
SSI	14.25	16.46	19.79	39	20
Social Security	263.95	277.89	286.75	9	3
Unemployment Insurance	20.06	28.20	34.55	72	22
Total	486.49	544.11	598.14	23	10

Source: Author's calculations based on Budget of the United States Government for Fiscal Year 1993, Appendix 1, Part 2.

The Gramm-Rudman-Hollings law in contrast imposed some discipline on entitlement spending. Under that law Congress was forced to reach a specific deficit target each year, which meant that any "unexpected" increases in spending on entitlements would necessitate painful spending cuts elsewhere in the budget. That served as a vital, though underappreciated, instrument of restraint. Under Gramm-Rudman real entitlement growth was less than 1 percent per year.

After just two years of the new budget deal, spending on entitlements have risen roughly five times faster than the rate of inflation. As Table 4 shows, after the first two years of the budget deal, entitlement spending exploded. From 1989 to 1992 real outlays for unemployment insurance climbed by 72 percent to $35 billion, food stamp spending was up by 46 percent, Medicaid assistance rose by 85 percent to $72 billion, and the budget for the Supplemental Security Income (SSI) program for the disabled shot up by 39 percent to $20 billion.

Although the 1990 budget law established a pay-as-you-go requirement--whereby newly created entitlements would have to be paid for with higher taxes or spending reductions--in the last days of the 1990 legislative session, Congress hurriedly enacted a new child-care program with a five-year price tag of $6 billion and a new Medicaid expansion that will cost more than $500 million. Both were exempt from the pay-as-you-go requirement. Moreover, the pay-as-you-go approach has not prevented expansions in Medicaid and the lengthening of unemployment insurance eligibility in the last year.[31]

A Kinder, Gentler Budget Process

The major casualty of the budget agreement of 1990 was the Gramm-Rudman-Hollings Deficit Reduction Act, which had been the law from 1986 through 1990. Most Americans have come to regard Gramm-Rudman as a great failure. The truth is that although the GRH budget law never worked as well as intended, it did force the deficit down from its peak of $220 billion to $150 billion in four years. Under GRH federal borrowing was slashed from 6 to less than 3 percent of GDP--an impressive accomplishment.

For years the spending coalitions in Congress were savage critics of Gramm-Rudman. Its ever-tightening noose had begun to choke program funding. The threat of the president's pulling the sequestration trigger of across-the- board spending reductions served as a vital device for enforcing moderate spending discipline on Capitol Hill. To avoid the draconian GRH sledgehammer, Congress begrudgingly allowed wasteful programs, such as general revenue sharing and Urban Development Action Grants (UDAGs), to be termi nated. Spending growth slowed to roughly 3.5 percent per year under GRH--about half what it had been before the law's enactment. In 1986 the law's sequestration process was invoked--requiring agencies to shrink their budgets by roughly 4 percent, forcing some layoffs, delaying purchases, allowing fewer grants to be issued, and necessitating other economies. The primary victim of the act was discretionary domestic programs. The act also effectively torpedoed efforts by Congress to create new programs.

The political problem for Congress and the White House in the summer of 1990 was that the anticipated deficit was some three times larger than the $64 billion GRH target. The specter of a $100 billion sequester loomed over the Capitol. That prospect made even the most vocal deficit- phobes nervous. Sen. Ernest F. Hollings, for years one of the most vocal critics of the "Reagan deficits," now announced that he wanted to scrap GRH and live under a new, less constraining budget regime. Most members of Congress agreed.

To accomplish the repeal of GRH, the tax-and-spend lobby engineered a full-scale propaganda campaign against the budget law. They argued that it was defective because it had not reduced the deficit as promised. They pointed to Gramm-Rudman's legacy of missed and revised deficit targets. In the spring of 1990 with the support of the White House and congressional leaders, the tax-and-spend coalition began to educate the public about the catastrophic effects of a GRH sequester.[32] Richard Darman issued frightening press releases threatening that a sequester would cripple the air traffic control system, slam shut the gates to the national parks, and force furloughs of FBI agents. The CBO said that there would be no money to prosecute drug kingpins, that veterans' hospitals would have to be closed, that transit systems would stop running, that college students would not be able to take out student loans, that housing shelters would lock out the homeless in the dead of winter, and other such horrors.[33]

Opponents of Gramm-Rudman even argued in a twisted sort of logic that spending reductions of $100 billion would be economically debilitating. The line from the White House and Congress was that the economy could never handle a $100 billion sequester. In other words, the same pundits who predicted economic Armageddon if the deficit were not reduced with a huge tax hike were complaining that a $100 billion spending cut would be ruinous. When anti-tax groups contended that a $150 billion tax hike would be at least as economically debilitating, the Washington establishment turned its back on its Keynesian orthodoxy and responded that in a nearly $6 trillion economy, the budget summit tax package would have an almost inconsequential effect.[34] "The real purpose of the new tax revenue increases," wrote former Treasury economist Paul Craig Roberts in the summer of 1990, "was not to cut the deficit, but to avoid a Gramm-Rudman sequester that would cut spending."[35]

Unfortunately, under the 1990 budget law, the heart and soul of GRH--legally enforceable deficit targets with the sequester enforcement mechanism--were extracted. The deficit ceiling under the new law was "adjustable" and could be raised if economic changes or inflation or other unpredictable factors arose that caused spending to increase or tax revenues to fall. The House Budget Committee, which helped construct the new law's "maximum deficit allowances," truthfully labeled them "largely irrelevant."[36] Nine months later America learned just how irrelevant the deficit targets really were when the deficit ballooned to a new all-time record of nearly $300 billion and yet Congress was not technically in violation of the new law. There are no automatic spending cuts.

The Impact of the Budget Deal on the Economy

In direct contrast to persistent administration and congressional hopes that the economy would surge after passage of a credible budget package, economic anemia has prevailed since October 1990. Table 5 compares the economic predictions made at the time of the budget deal with the actual performance of the economy since then and the latest forecast for 1993-95.

A few supply-side economists had predicted the harmful impact of the 1990 Budget Act on the economy. One study by the National Center for Policy Analysis predicted in January 1991 that the net effect of the budget bill's $165 billion tax hike through 1995 would be the loss of 500,000 jobs; a reduction of GDP to $240 billion below the level otherwise achieved; and a loss of output equaling roughly $1,000 for every man, woman, and child in the United States.[37] That conclusion was corroborated in a Cato Institute study by economists William C. Dunkelberg of Temple University and John Skorburg of the Chicago Association of Commerce and Industry. They found that rather than having a positive economic effect, between 1991 and 1995 the budget agreement would cost the economy 0.7 percent of GDP and 400,000 jobs.[38] Dunkelburg and Skorburg found that $330 billion of the alleged $500 billion savings--or two-thirds of the total--would be wiped out as a consequence of the lower growth rate. Those deficit and economic predictions, based on a dynamic estimate of the economy's reaction to the new taxes, turned out to be far more accurate than the predictions originally issued by the Office of Management and Budget and the Congressional Budget Office.

Table 5
The Economic Response to the 1990 Budget Deal

	October 1990	1991	1992
Unemployment rate (%)	5.5	6.7	7.7
Inflation (%)	4.3	3.6	2.5
Real GDP (% Change)	1.0	-1.2	2.0
Employment (millions)	117.9	116.9	117.8
Real per capita disposable income	$14,068	$13,886	$14,030

The 1990 tax increase was a case study of the principles of the Laffer curve: higher taxes reduce economic growth and thus federal revenues.[39] For the six years before the budget agreement (1985-90), with almost no new taxes, federal revenues climbed by a healthy 8 percent per year. In 1991, despite an increase in income tax rates, a hike in the gasoline tax, the introduction of a 10 percent surcharge on luxury items, and a variety of other new levies, total real federal tax collections fell by $19 billion. Matthew Kibbe, an economist at the U.S. Chamber of Commerce, reported that "81 percent of the revenues expected from the tax increases failed to materialize."[40] Whereas the budget agreement was supposed to raise $165 billion in revenues, in fact the most recent forecasts showed it would raise $32 billion and the blue-chip economic forecasts suggested that it would raise a minuscule $6 billion. In other words, higher tax rates were producing virtually no additional tax revenues.

Conclusion

The 1990 budget deal was a genuine triumph of politics. There can be no question that the tax-and-spend coalitions inside and outside Congress were the major victors in the budget deal. They won because they realized what President

Bush and the balanced-budget crowd never understood until it was too late to matter: even if enforced, the 1990 budget pact would permit spending to rise to levels far above what could have been achieved within the bounds of normal political and fiscal constraints.

There are three primary lessons to be learned from the 1990 budget deal as Congress and the next president deal with a much worsened budget situation. First, bipartisan budget summits almost never produce the lower deficits that are promised. Second, budget summit tax hikes are never imposed in addition to spending cuts; they are always imposed instead of cuts. That was clearly the agenda of Congress in 1990 as it front-loaded all the tax increases to the beginning of the five-year period and delayed the supposed deep, painful spending cuts until 1993, 1994, and 1995. Those cuts have not materialized, and they are not now expected to ever materialize. Finally, another deficit reduction summit in 1993 would yield similarly disappointing results.

The only way to eliminate the deficit in this century is to enact a balanced-budget amendment and reinstate the Gramm-Rudman deficit reduction law with steadily declining debt ceilings. America cannot afford any more deals of the century.

Notes

[1] For instance, during the recent debate over a balanced- budget amendment in the House, Panetta argued persistently that the measure was unnecessary because the spending caps under the budget deal would cut the deficit.

[2] Robert D. Reischauer, Remarks before the National Econo mists Club, October 24, 1991.

[3] Although the Democrats and the media have been saying that the 1982 tax increase was the largest ever, that tax hike raised $17.5 billion in the first year. The 1990 bud get act raised $25.5 billion in the first year. Dan Mitch ell, "Anatomy of a Phony Story," National Review, September 14, 1992, pp. 50-51.

[4] Economic Report of the President, February 1992.

[5] Paul G. Merski, "A Decade of Budget Summitry," Tax Foun dation, June 1990.

[6] Congressional Budget Office, "The 1990 Budget Agreement: An Interim Assessment," December 1990.

[7] Robert J. Samuelson, "The Right Way to Think about Taxes," Newsweek, July 9, 1990, p. 21; and David Gergen, "Lip Balm for Bush," U.S. News & World Report, July 9, 1990, p. 84.

[8] About the budget deal, Alan Greenspan warned, "Failure to enact the agreement would produce an adverse reaction in financial markets that could undercut our economy." Quoted in Lawrence Barett, "1000 Points of Spite," Time, October 15, 1990, p. 35.

[9] Congressional Budget Office, "The Economic and Budget Outlook: Update," August 1992.

[10] "Economists Shifting in Priorities," New York Times, March 31, 1992.

[11] Paul Craig Roberts, "Bush's Teflon Deficits," Wall Street Journal, May 6, 1991.

[12] "Economists Urge Investing Stimulus, Washington Post, March 31, 1992.

[13] Martin Feldstein, "Bush's Budget Deal Made Deficit Big ger," Wall Street Journal, November 29, 1990.

[14] The treatment of the savings-and-loan bailout in the budget agreement is discussed in Scott Hodge, "Budget Sav ings Mean More Taxes," Wall Street Journal, November 9, 1990.

[15] Daniel J. Mitchell, "The Budget Summit Agreement: Faulty Economic Assumptions," Heritage Foundation Backgrounder Update, October 3, 1990.

[16] Feldstein.

[17] Office of Management and Budget, "Mid Session Review of the Budget," July 15, 1991, p. iii.

[18] Congressional Budget Office, "The Economic and Budget Outlook: Update," August 1991.

[19] Alan Murray, "Last Year's Budget Pact Gains New Admirers for Restraining Spending," Wall Street Journal, July 30, 1991.

[20] Ibid.

[21] Gary Robbins and Aldona Robbins, "If the Budget Summit Was a Success, Why Is the Five-Year Deficit Heading toward $1 Trillion?" National Center for Policy Analysis, Policy Backgrounder no. 109, March, 1991.

[22] Howard Gleckman, "The Budget: Never Make a Tough Choice Today...," Business Week, November 12, 1990, pp. 43-45.

[23] Robert Pear, "Budget Reduction Deals That Could Swell the Deficit," New York Times, October 22, 1992, p. 6.

[24] Ibid.

[25] John Lancaster, "Parks, Perks, and Pork," Washington Post, December 1, 1990, pp. A1, A8.

[26] Ibid.

[27] Rudolph Penner, Urban Institute, newsletter, February 1991.

[28] Quoted in Gleckman.

[29] Richard E. Cohen, "Under the Hype, It's Just Stale