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The President's Fiscal Year 1994 Budget

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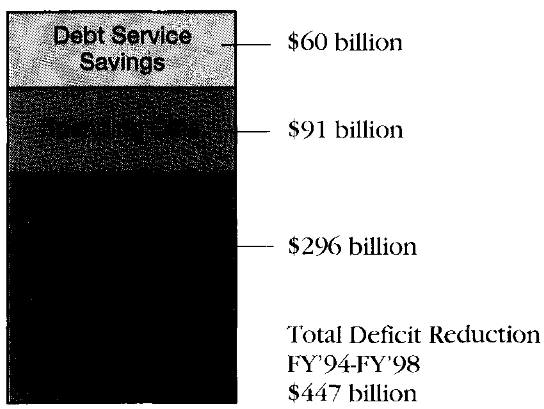
The Clinton administration has released its fiscal 1994 budget, which lays out in detail proposals contained in its February economic statement, *A Vision of Change for America.* The budget focuses on the dual goals of deficit reduction and increased spending on "investments." On the first goal, the president's plan proposes to narrow the deficit to $250 billion by FY'98, compared to the record FY'93 deficit of $322 billion.

On the second goal, the president has proposed increased investment spending totaling $140 billion over the FY'94 to FY'98 period. This spending will mean discretionary spending caps set for FY'94 and FY'95 by the 1990 Budget Enforcement Act will be exceeded.

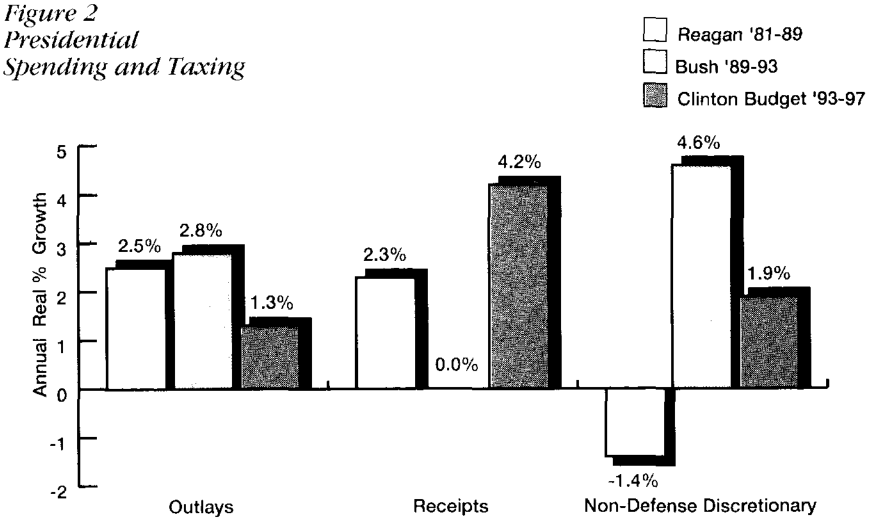
The Clinton budget proposes a 34 percent increase in federal revenues and a 21 percent increase in federal spending over five years. For FY'94, revenues would go up 9.2 percent and spending would rise 3.3 percent over FY'93 levels.

Figure 1
Clinton Deficit Reduction Breakdown



Source: Office of Management and Budget.

Figure 2
Presidential Spending and Taxing



Source: Tax Foundation.

The Deficit

The Clinton administration's budget claims $447 billion of total deficit reduction over five years from baseline deficit growth. *Figure 1* breaks the deficit reduction into tax increase and spending cut components.

Despite the substantial deficit reduction claimed, the actual annual deficit is projected to remain high, as *Table 1* indicates. The era of greater than $200 billion deficits that began in 1983 continues uninterrupted through the president's five-year budget proposals.

Figure 1 indicates that there are over three dollars of tax increases for each dollar of spending cuts in the budget. This ratio understates the actual tax increases compared to spending cuts in the budget. Not included in the $296 billion of tax increases are $18 billion in fee increases. In addition, the deficit reduction components in *Figure 1* are measured from the administration's deficit baseline which is markedly different from the deficit baseline of both the Congressional Budget Office (CBO) and that estimated by the outgoing Bush administration. Of the $447 deficit reduction claimed, $92 billion can be traced to a deficit baseline inflated above the CBO's baseline, and not to any policy change. See *Table 2* for baseline deficit projections.

While the Clinton administration's budget projects the deficit to decline, the modest fall will not appreciably slow the growth in accumulated federal public debt, now totaling over $3 trillion (see *Figure 3*). Even as the deficit falls from FY'93 to FY'96, the debt is so large that federal interest payments under the Clinton budget plan will actually increase over that period from $202 billion to $244 billion (see *Table 1*). In FY'93, interest payments claimed 18 cents out of every federal tax dollar.

Spending Totals

President Clinton's budget does not cut total federal spending in any year over the five-year plan despite deep cuts in defense spending. In fact, total spending will rise from $1.468 trillion in FY'93 to $1.781 in FY'98, a 21 percent increase. After inflation, spending will rise by four percent over the period.

Actual outlays are not cut in any major category of spending except defense. *Figure 4* shows that both mandatory and non-defense discretionary spending increase significantly over the five-year budget plan. The $91 billion in "cuts" claimed are decreases from the budget baseline increases, not actual dollar cuts as an average American would understand them.

Spending Priorities

The most dramatic change in the composition of federal spending proposed in the Clinton budget is the reduction in national

Table 1: Federal Outlays, Receipts, and Deficits with the Clinton Plan ($Billions)

	Total Outlays	Total Receipts	Deficits	Net Interest Outlays	Total Outlays as a Percent of GDP	Receipts as a Percent of GDP	Deficits as a Percent of GDP	Interest Outlays as a Percent of GDP
1980	591	517	74	53	22.3	19.6	2.8	2.0
1981	678	599	79	69	22.9	20.2	2.7	2.3
1982	746	618	128	85	23.9	19.8	4.1	2.7
1983	808	601	208	90	24.4	18.1	6.3	2.7
1984	852	667	185	111	23.1	18.0	5.0	3.0
1985	946	734	212	130	23.9	18.5	5.4	3.3
1986	990	769	221	136	23.5	18.2	5.2	3.2
1987	1004	854	150	139	22.5	19.2	3.4	3.1
1988	1064	909	155	152	22.1	18.9	3.2	3.2
1989	1143	991	153	169	22.1	19.2	2.9	3.3
1990	1253	1031	221	184	22.9	18.9	4.0	3.4
1991	1324	1054	270	195	23.5	18.7	4.8	3.5
1992	1381	1091	290	199	23.5	18.6	4.9	3.4
1993e	1468	1146	322	202	23.6	18.3	5.4	3.2
1994e	1515	1251	264	212	22.9	19.0	4.0	3.2
1995e	1574	1328	247	228	22.5	19.1	3.5	3.3
1996e	1625	1413	212	244	22.1	19.3	2.9	3.3
1997e	1690	1413	214	258	22.0	19.3	2.7	3.4
1998e	1781	1531	250	273	22.2	19.2	3.1	3.4

Source: Office of Management and Budget.

Table 2: Deficit Estimates ($Billions)

	1992	1993	1994	1995	1996	1997	1998
Bush Baseline	-290	-327	-270	-230	-266	-305	-320
CBO Baseline	-290	-302	-287	-284	-290	-322	-360
Clinton Baseline	-290	-310	-302	-301	-298	-347	-387
Clinton Proposed	-290	-322	-264	-247	-212	-214	-250

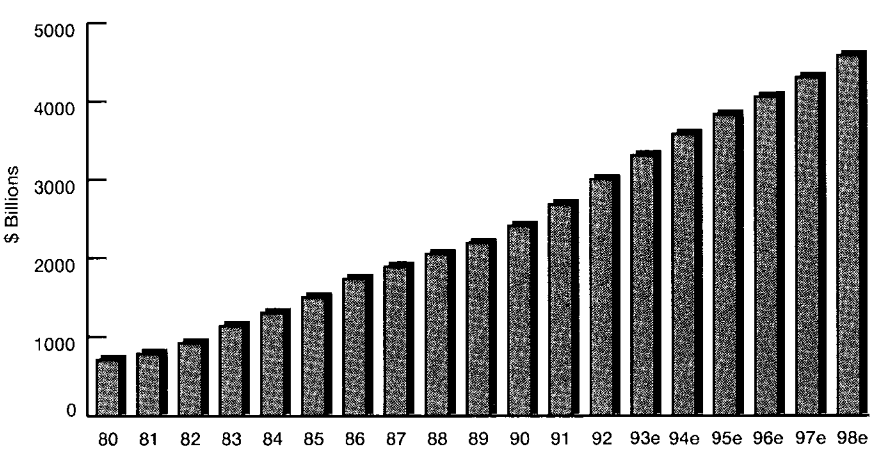
Notes: Bush and CBO Baseline assume BEA caps in force. "Baseline" figures represent projected deficits assuming no changes in law.
Sources: Office of Management and Budget, Congressional Budget Office.

Table 3: Budget Outlays by Function and Major Category

	FY'93	FY'94	FY'98	% Change FY'93-FY'98
National Defense	290.6	276.9	252.5	-13.1
International Affairs	18.3	19.0	18.8	2.7
General Science, Space, and Technology	17.1	17.8	20.7	21.1
Energy	5.5	3.9	4.5	-18.2
Natural Resources and Environment	21.9	20.8	21.6	-1.4
Agriculture	21.9	17.2	12.6	-42.5
Commerce and Housing Credit	9.8	13.2	-7.1	-
Transportation	36.9	40.1	43.9	19.0
Community and Regional Development	9.9	10.1	8.4	-15.2
Education, Training, and Employment	53.4	53.6	65.2	22.1
Health	105.3	117.8	181.1	72.0
Medicare	132.7	147.4	215.5	62.4
Income Security	209.2	215.0	257.6	23.1
Social Security	304.9	320.7	383.6	25.8
Veterans	35.6	37.9	38.6	8.4
Justice	15.4	16.2	19.3	25.3
General Government	14.8	14.2	14.9	0.7
Net Interest	201.5	212.1	272.3	35.1
Allowances	0.0	-0.7	-1.2	-
Undistributed Offsetting Receipts	-37.3	-37.5	-41.6	-

Source: Office of Management and Budget.

Figure 3
Debt Held by the Public
Fiscal Years 80-98



Source: Office of Management and Budget.

defense spending. Defense spending would fall from $292 billion in FY'93 to $254 billion in FY'98. Considered against total federal spending, this is a dramatic fall. Defense spending represented 20 percent of federal spending in FY'93 and will fall to 14 percent by FY'98 under the Clinton budget plan (see *Table 3* and *Figure 4*).

In contrast, total nondefense spending will increase from $1,176 billion to $1,528 billion over the five-year budget plan. The fastest federal spending growth will occur in the so-called mandatory spending programs. Mandatory spending programs do not go through an annual authorization and appropriation process. These programs grow automatically as demands on the programs increase, unless specific reform legislation is enacted. Three programs, Social Security, Medicare, and Medicaid, constitute the bulk of mandatory spending and are all projected to grow quickly (see *Figure 5*). These three programs alone constituted 35 percent of all federal spending in FY'93 and will take 42 percent of all federal spending by FY'98 under the president's budget plan.

The president's budget also contains significant increases in non-defense discretionary spending. The president's "investment" initiatives include $140 billion in new spending including $52 billion on highways and infrastructure, $52 billion for "lifelong learning," and $32 billion for health research.

Tax Proposals

The "sacrifice" portion of President Clinton's budget plan includes gross tax increases totaling $351 billion over five years. The president's budget also calls for $55 billion in targeted tax relief proposals, so that the net tax increase amounts to $296 billion. In addition, $18 billion of fee increases are included in the budget but not included in this tax increase total.

The largest tax proposal in the plan is the tax increase on higher income earners. This proposal, which the administration hopes will raise $123 billion, includes adding a new top income tax bracket of 36 percent for earnings in excess of $140,000 (joint returns), and placing a new 10 percent surcharge on taxable income above $250,000.

The second largest tax increase in the plan is a new broad-based energy tax, or "Btu" tax, that is projected to raise $73 billion. The Btu tax will impact all Americans, one way or another, by increasing the price of gasoline, home heating fuels, and other energy products.

The president's budget includes a provision to raise an additional $23 billion in income taxes from increasing the amount of Social Security benefits that are taxable, from 50 to 85 percent. Tax relief for lower-income earners comes in the form of an increase in the earned income tax credit resulting in a reduction in tax revenue totalling $25 billion over the five-year budget plan.

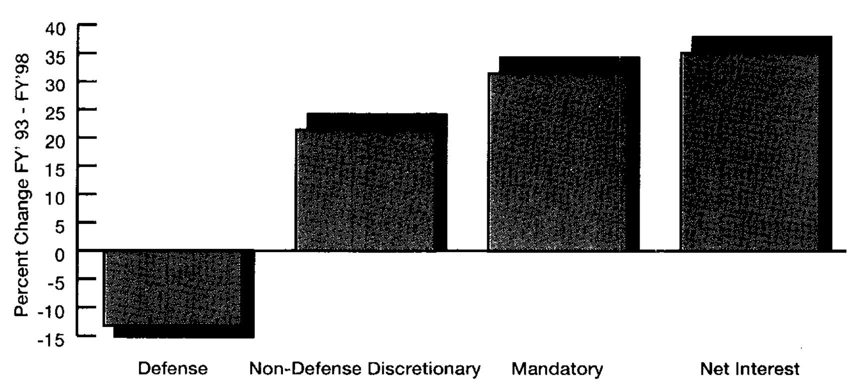
President Clinton has proposed significant tax increases on business, including raising the top corporate tax rate to 36 percent in the hopes of raising an extra $28 billion over five years.

Whatever the merit of relying heavily on tax increases rather than spending cuts to reduce the deficit, the revenue gains from the president's tax increases may be overstated. A recent study by the National Bureau of Economic Research (NBER) concludes that relatively small behavior changes from taxpayers in the face of higher tax rates may eliminate much of the extra revenue on which the Clinton budget counts. In response to higher marginal tax rates, taxpayers may work less, defer their income, or move their work and income to less-taxed areas of the economy.

The NBER study finds, for example, that a couple earning $180,000 per year would pay an additional $3,505 in income and Medicare payroll taxes under the Clinton plan if they, like robots, didn't change their economic behavior. If, however, the couple reduces their taxable income by just 5 percent, to $171,000, the government would actually lose more tax revenue than it gains from the higher tax rates. It is not inconceivable, therefore, that we may end up with lower economic growth, less after-tax income, higher tax rates, and a higher deficit if the Congress enacts President Clinton's deficit reduction plan which relies primarily on tax increases and not spending cuts.

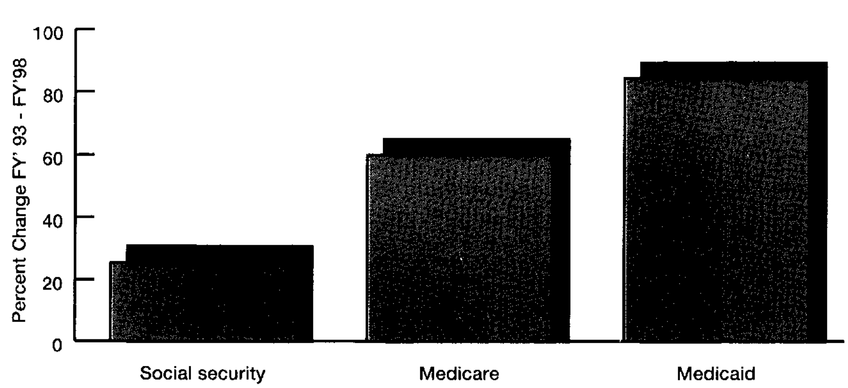
For a detailed breakdown of the impact President Clinton's tax proposals will have on federal revenues, see *Table 4*. *Table 5* and *Figure 6* show federal revenues by source.

Figure 4
Clinton Budget Spending
Changes by Major Category FY'93 - FY'98



Source: Office of Management and Budget.

Figure 5
Clinton Budget Spending
Increases on Mandatory Programs FY'93 - FY'98



Source: Office of Management and Budget.

Presidential Comparison

Figure 2 compares the spending and taxing record of Presidents Reagan and Bush with President Clinton's proposed budget in inflation-adjusted dollars. Some differences are stark. Whereas President Bush presided over the faster growth in federal spending, President Clinton's plan proposes annual revenue increases far outpacing either Presidents Bush or Reagan. Total spending grew quickly under President Reagan, in part because of the national defense buildup. In fact, *Figure 2* indicates that non-defense discretionary spending actually fell, in real terms, during Reagan's two terms in office. In contrast, President Bush increased non-defense discretionary spending at a 4.6 percent annual rate, faster than President Clinton's proposed 1.9 percent annual increases.

The fast growth in spending under President Bush was coupled with federal revenues which were stagnant during his four years in office. The large tax increases passed in 1990 canceled out falling revenues due to the recession. The result was a ballooning deficit which grew to a record $322 billion by FY'93 from $153 billion in FY'89.

Despite political rhetoric to the contrary,

Table 4
Impact of Budget Proposals on Federal Revenues from Budget Baseline ($Billions)

Proposed Legislation	1993	1994	1995	Fiscal Years 1996	1997	1998	1994-1998
				Revenue Increases			
Individuals							
Raise income taxes for high-income individuals	1.6	27.5	19.6	22.7	26.0	27.4	123.2
Repeal health insurance wage cap base	-	2.8	6.0	6.4	6.8	7.2	29.2
Tax 85% of Social Security benefits	-	1.7	5.0	5.3	5.5	5.7	23.2
Reduce deductible portion of business meals	-	1.8	3.2	3.4	3.7	4.0	16.1
Reduce acceptable contributions for retirement plans	-	0.3	0.8	0.8	0.9	0.9	3.6
Reinstate top estate tax rates at 53% and 55%	-	0.5	0.5	0.6	0.6	0.6	2.7
Disallow certain moving deductions	-	0.1	0.4	0.4	0.4	0.4	1.7
Deny deduction for club dues	-	0.1	0.2	0.3	0.3	0.3	1.2
Deny deductions for executive pay over $1m	-	0.1	0.0	0.1	0.1	0.2	0.6
Businesses							
Increase top corporate income tax rate to 36%	0.4	7.5	5.0	5.1	5.2	5.3	28.1
Limit 936 credit to 60% of compensation	-	0.2	0.9	1.7	2.1	2.3	7.2
Securities dealers mark-to-market	-	1.0	1.1	1.1	1.1	0.7	5.0
Extend corporate estimated tax rules	-	-	-	-	3.9	0.8	4.7
Deny deduction for lobbying expenses	-	0.1	0.2	0.2	0.2	0.2	0.9
Prohibit double-dip related to FSLIC assistance	0.6	0.4	0.0	0.1	0.2	0.1	0.7
International tax provisions	-	0.2	0.1	0.1	0.1	0.1	11.0
Energy							
BTU energy tax	-	2.0	9.3	16.7	22.1	22.7	72.8
Extend gasoline tax	-	-	-	2.6	2.6	2.6	7.8
Compliance							
Compliance understatement penalty modification	-	0.3	0.6	0.4	0.3	0.3	1.9
Service industry non-compliance initiative	-	0.1	0.6	1.3	1.9	2.2	6.2
Miscellaneous	-	0.2	0.3	0.6	0.8	0.9	2.8
Total Revenue Increases	2.6	46.9	53.8	69.9	84.8	84.9	350.6
				Revenue Decreases			
Training and Education							
Extend employee-provided education assistance	-0.5	-0.4	-0.5	-0.5	-0.5	-0.6	-2.9
Extend targetted jobs tax credit	0.0	-0.1	-0.2	-0.3	-0.3	-0.4	-1.5
Youth apprenticeship credit	0.0	0.0	-0.1	-0.1	-0.2	-0.2	-0.6
Investment							
Incremental Investment Tax Credit	-4.6	-9.2	-6.7	-3.1	-2.3	-2.9	-28.9
Extend research and experiment credit	-0.9	-1.2	-1.5	-1.8	-2.0	-2.2	-9.6
Modify AMT depreciation schedule	-0.1	-0.2	-0.3	-0.4	-0.4	-0.3	-1.6
Incentives for small businesses	0.0	0.0	-0.1	-0.2	-0.2	-0.2	-0.7
Extend small-issue bond subsidy	0.0	0.0	0.0	0.0	0.0	0.0	-0.2
Real Estate							
Extend mortgage revenue bonds permanently	0.0	-0.2	-0.5	-0.8	-1.1	-1.4	-4.1
Extend low-income housing credit	0.0	-0.1	-0.1	-0.2	-0.2	-0.2	-0.8
Modify various rules wrt treatment of individuals	0.0	-0.3	-0.4	-0.2	0.0	0.2	-0.7
Other							
Enterprise Zones	0.0	-0.1	-0.3	-0.8	-1.2	-1.7	-4.1
Extend self-employed health insurance deduction	-0.3	-0.3	0.0	0.0	0.0	0.0	-0.6
Extend AMT of apprec. property to charities	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4
Expanded Earned Income Tax Credit*	0.0	-0.3	-3.4	-6.7	-6.9	-7.2	-24.5
Total Revenue Decreases	-6.0	-12.1	-12.4	-9.9	-9.3	-11.0	-54.7
Net Revenue Increases	-3.4	34.8	41.4	60.0	75.5	73.9	295.9

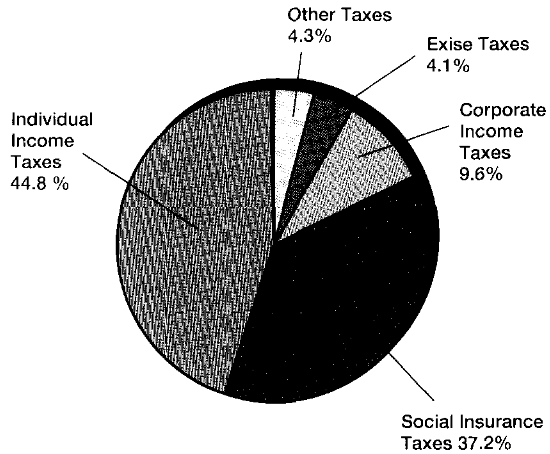
* EITC not included in totals
Source: Office of Management and Budget.

Table 5:
Federal Receipts by Source Under Clinton Budget

	FY'80	FY'93	FY'98	% Change FY'93-98
Individual Income Taxes	244.1	515.3	680.3	32.0
Corporate Income Taxes	64.6	106.3	140.7	32.4
Social Insurance Taxes	157.8	426.8	560.0	31.2
Excise Taxes	24.3	47.6	82.7	73.7
Other Taxes and Fees	26.3	49.7	66.8	34.4
Total Receipts	517.1	1145.7	1530.5	33.6

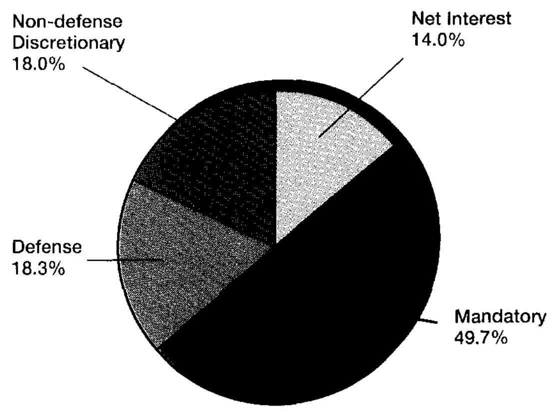
Source: Office of Management and Budget.

Figure 6
Federal Receipts by Source FY'94



Source: Office of Management and Budget.

Figure 7
Budget Outlays by Major Category FY'94



Source: Office of Management and Budget.

presidents are only partly masters of their own budgetary records. Recent forecasts for the nation's economy indicate President Clinton may be blessed with sustained economic growth and low interest rates during his first years in office. Both of these factors will automatically lower the federal deficit without any legislative action by the government. For example, each one percentage point in lower interest rates will reduce the federal government's net interest outlays on the debt by about $30 billion annually.

Blown Budget Deals

President Clinton's budget proposes discretionary spending totals for FY'94 and FY'95 that exceed the limits set in the 1990 Budget Enforcement Act. This is unfortunate, but in Washington budget deals to reduce the deficit are routinely made and then broken. Efforts at "deficit reduction" in 1982, 1984, 1985, 1987, and 1989 included immediate tax hikes and promised spending cuts in future years. The usual result was that Congress enacted the tax increases, ignored any significant spending cuts, and created higher deficits.

The most recent effort at reducing the deficit also follows this pattern and was the product of prolonged budget summitry between President Bush and congressional leaders. The Omnibus Budget Reconciliation Act of 1990 (OBRA) sold $164 billion of tax increases to the public on the promise of $500 billion of deficit reduction. The cumulative FY'91-95 deficit was to be brought down to $527 billion. Now, midway through the plan, the five-year total deficit is estimated to be $1.4 trillion, or $875 billion more than promised.

Although the deficit targets of OBRA have been far exceeded, the Act did introduce important budget process reforms, in particular, the Budget Enforcement Act, or BEA. So-called mandatory spending programs, such as Social Security, are now subject to "pay-as-you-go" discipline which limits the ability of new laws to expand the programs and increase the deficit.

In addition, the BEA introduced discretionary spending caps for FY'91 through FY'95 which trigger sequesters if they are exceeded. President Clinton's plan includes FY'94 discretionary spending of $550.1 billion, exceeding the FY'94 BEA cap of $544.7 billion. But by declaring an "emergency," the president's budget proposes to spend in excess of the cap, thus following the Washington budget tradition of taxing first and not following through with spending cuts later.

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