

Pulling Off the Budget Deal: A Long Way To Go

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Looking simply at the amount of deficit reduction needed by the year 2002, this should be an easy budget deal to pull off. Since 1982, we have had a major budget deal about every three years (1982, 1984, 1987, 1990, and 1993, among others). The 1997 deal will be among the smaller of them. The economy has done modestly well recently, revenues are higher than projected, some costs are lower than projected a few months ago, and the deficit for this fiscal year is already projected to be well below \$100 billion. Tax cuts are available to sweeten the pie. Both political parties are committed to the deal, partly to fulfill past campaign promises, and partly to avoid being tainted as obstacles to progress.

All these factors make it extremely likely that there will be a final deal, but they do not mitigate the difficulty in getting there. Simply put, the deal is clearly overcommitted. Politicians who promise more than they can deliver represent only the first, and least unexpected, of the problems. For example, adding together past promises of child credits, capital gains and estate tax cuts, individual retirement provisions, extensions of tax breaks in current law and other provisions results in a tax cut that is a multiple of what is allowed under the deal hammered out between the White House and congressional Republicans (see, for instance, Tax Notes, May 12, 1997, p. 740). But cutting back on the promises in some ways is the easy part of the battle. Some were known to be excessive from the start; a few might even be ignored.

What has not been given much attention is the extraordinary technical difficulty that is imposed by the multiple numerical targets that came out of the budget deal. Almost any attempt to set a policy course is likely to have a negative impact on many numerical targets. Each target will then be met only by adopting multiple other changes that themselves are likely to violate the other targets. No sooner will one objection be met than Congress will find itself facing two new ones.

This may sound a bit abstract, but remember that the president and Congress have not agreed to any particular set of tax or expenditure policies. The goals are deficit reduction and some tax cuts. Outside of those goals, they have agreed mainly to a whole series of numbers without knowing what policies will fit into those numbers. All one really knows is that hundreds of policies will be changed in ways that, when all is said and done, will supposedly meet the multiple targets.

Among these many targets are net tax cuts of no more than \$85 billion over five years; a budget with a near-zero deficit in the year 2002; net tax cuts of no more than \$250 billion over 10 years; \$35 billion for tuition tax credits and educational tax deductions over five years; and Medicare cuts of \$115 billion over five years. Some lesser numerical goals have also been stated, although there is a bit more flexibility here: for example, the \$85 billion of net tax cuts is supposed to be derived from \$135 billion of gross tax cuts and \$50 billion of gross tax increases. Even then, we are not done. The path toward a zero deficit by 2002 can't be too crooked and significant deficits right after 2002 are probably not acceptable. No one has yet even mentioned the distributional tables that typically accompany tax reforms; any deal probably cannot go too far in violating some sense of fairness as represented, whether well or poorly, in those tables.

My point is not simply that Congress cannot easily meet so many numerical goals because of their political difficulty. It is that these targets would be hard to achieve mathematically even if there was only one party to the negotiations. Policies often do not accommodate themselves so easily to numerical goals.

Not every part of the bill will be difficult. For instance, Congress will almost certainly provide less estate tax relief than Republicans had advocated in their earlier bills. Such a reduction in promises is relatively straightforward. For example, the unified credit against tax can be raised very gradually, and any relief for farms and small businesses can be tightly woven so costs are minimal. Even here, however, more estates are becoming subject to tax over time, so it's hard to prevent any relief from growing in later years -- thus threatening the 10-year targets even if the 2002 zero deficit goal is more easily met.

In other cases, the multiple constraints are much harder to reconcile. Take the back-loaded individual retirement account. Initially, this proposal raises money, as people forgo a tax deduction in the current year to obtain tax-free income for the rest of their lives. Thus, it might be easy to allow these accounts to be set up over the course of the next few years without affecting deficit targets in the early years. However, the costs of these accounts rise rapidly and are very threatening to any 10-year budget constraint.

When it comes to Medicare, long-term contracts to provide low-income housing, and a number of other expenditure programs, the numerical consequences of many policy choices will be hard initially to predict with any precision. Congress may decide to control costs in health care in one way, only to find that such controls achieve more than required over a 10-year period, but not enough over five years. Perhaps the 2002 target is not help enough. Or Congress may try to extend subsidies for housing in one way, only to find that they cost a lot in the year 2002, the one year when the strict goal of budgetary balance makes such costs excessive. Since the taxwriting committees will be on their own track, there will be little ability to walk back and forth from expenditures to taxes to gain access to policy choices on the other side of the accounting ledger.

Now try to think through what will happen when a member tries to propose an amendment to a bill -- say, one offered to the chairman's bill (or "mark") that is often the base from which the taxwriting committees proceed. If there were only one numerical constraint, it would be bad enough. Take a single target, such as \$500 billion in deficit reduction over five years. If one had an amendment that cost \$5 billion, then three or four other changes might need to be cobbled together in a way that they added up to \$5 billion in revenue pickup. What happened in other years, however, would not be of any major consequence.

Now carry this same amendment forward to the current budget negotiations. Suppose that the same amendment not only involves \$5 billion in costs over 5 years, but also \$2 billion in costs in 2002 and \$20 billion over 10 years. Having found a series of offsetting provisions for the five-year period, all of a sudden one finds that they fall short of the 2002 target and the 10-year target. Another three or four provisions are tacked on to raise revenues in those later years, but then they also raise revenues for the five-year period and for the year 2002. A couple more provisions are then changed to reduce the revenue pickup in the first years, but then the 10-year target is more than met. And so on, almost endlessly. Estimators and lobbyists alike will be trying to find all sorts of detailed changes that juggle and re-juggle the ways that these numbers play out.

Unfortunately, most of this juggling will not be aimed at achieving better tax or expenditure policy. Indeed, these efforts are likely to add considerably to inequities among taxpayers, distortions in the timing of action by workers and investors, and more complexity and administrative costs than would be required under a more straightforward process. Deficit reduction will be achieved, but not without costs -- and not without much wrangling over how to get there.

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