The Budget Reconciliation Act of 1993: A Summary Report
by David Altig and Jagadeesh Gokhale

On August 5, the U.S. Senate cleared the Omnibus Budget Reconciliation Act of 1993 (OBRA93), one day after the House of Representatives had done likewise. President Clinton signed the bill into law on August 10, formalizing its role as the central fiscal blueprint for the nation's economy over the next five years.

Passage of OBRA93 followed an extended period of vigorous debate instigated by the administration's publication of A Vision of Change for America (henceforth referred to as Vision) and the President's State of the Union address in February. In an earlier Economic Commentary, we published an overview of the administration's proposals. Our primary conclusions were as follows:

- The majority of proposed deficit cuts, in dollar terms, would be deferred to the later years of the plan, with 70 percent of the total being realized in fiscal years (FY) 1997-98.
- Through FY1995, planned revenue increases would actually exceed deficit cuts and would cumulatively account for 75 percent of the total dollar reduction in deficits over the entire six-year horizon.
- The plan would shift resources, via both expenditure and tax policy, toward nondefense discretionary spending.
- The plan would reduce the net payment burden of future generations.

Although OBRA93 retained much of the President's original plan, some of our conclusions are indeed altered by the provisions in the final budget bill. In this article, we summarize those differences and outline the legislation's revenue, spending, and deficit details. Using recently published data by the Congressional Budget Office (CBO), we conclude that:

- Compared to the Clinton plan, OBRA93 provides more deficit reduction over its first three years, in both absolute terms and as a percentage of the FY 1994–98 total. However, it remains true that the majority of cuts in dollar terms (60 percent) is deferred to FY1997 and FY1998.
- Revenue increases are still the largest source of deficit reduction, but account for only 56 percent of the total in OBRA93, as opposed to more than 70 percent in the administration's original proposal. Furthermore, unlike the Clinton plan, in no year does the bill entail revenue increases that exceed that year's dollar amount of deficit reduction.
- OBRA93, like the Clinton plan, does provide for a rise in total nondefense discretionary spending.
- Although reduced health benefits, taxation of Social Security benefits, and higher income taxes raise the net tax burden of all living generations, over the immediate horizon the increases are larger for older generations.

The final budget bill that was enacted this past summer contains some significant differences from the administration's original proposals. These involve the scope and timing of deficit reductions and the amount and distribution of revenue increases. Here, the authors use new data from both the Congressional Budget Office and the Office of Management and Budget to assess changes in lifetime tax burdens created by the new legislation and to explore prospects for real deficit reduction in the budget bill.

The Bottom Line
The analysis here and in the following two sections relies largely on numbers produced by the CBO. These estimates differ from the administration's, which are produced by the Office of Management and Budget (OMB), for a variety of technical reasons. The most important of these for our purposes is the exclusion of spending reductions mandated by prior legislation. Specifically, the CBO does not allocate to OBRA93 spending cuts that are required by the Budget Enforcement Act of 1990—a position that we find appropriate.

The CBO calculates that from FY1994 through FY1998, the budget bill is projected to reduce deficits by a cumulative total of $433 billion below what
FIGURE 1 DEFICIT REDUCTION IN OBRA93 AND IN THE ADMINISTRATION'S PROPOSAL

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>OBRA93</th>
<th>Administration's proposal</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994</td>
<td>140</td>
<td>120</td>
</tr>
<tr>
<td>1995</td>
<td>120</td>
<td>120</td>
</tr>
<tr>
<td>1996</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>1997</td>
<td>80</td>
<td>80</td>
</tr>
<tr>
<td>1998</td>
<td>60</td>
<td>60</td>
</tr>
</tbody>
</table>

SOURCE: Congressional Budget Office.

TABLE 1 EFFECTS OF OBRA93 TAX CHANGES BY INCOME GROUP

<table>
<thead>
<tr>
<th>Family Income</th>
<th>Average Change in Taxes, FY1994-98</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $10,000</td>
<td>-68</td>
</tr>
<tr>
<td>$10,000 - $20,000</td>
<td>-86</td>
</tr>
<tr>
<td>$20,000 - $30,000</td>
<td>-41</td>
</tr>
<tr>
<td>$30,000 - $40,000</td>
<td>50</td>
</tr>
<tr>
<td>$40,000 - $50,000</td>
<td>105</td>
</tr>
<tr>
<td>$50,000 - $75,000</td>
<td>192</td>
</tr>
<tr>
<td>$75,000 - $100,000</td>
<td>312</td>
</tr>
<tr>
<td>$100,000 - $200,000</td>
<td>649</td>
</tr>
<tr>
<td>$200,000 or more</td>
<td>23,521</td>
</tr>
</tbody>
</table>

SOURCE: Congressional Budget Office.

A Closer Look at the Revenue Side

Increased revenues account for nearly 56 percent of the $433 billion deficit reduction total. This is substantially lower than the 70 percent share proposed by the administration, because OBRA93 reflects both larger spending cuts and lower revenue collections. The most significant element of the latter arises from a scaling back of the President’s initial energy tax proposals.

The distribution of total revenue increases in the new legislation is illustrated in figure 2. Approximately 58 percent of the total is associated with taxes aimed at high-income individuals, including both higher income-tax rates and Medicare payroll taxes. However, as shown in table 1, the CBO calculates that the majority of taxpayers (starting with a family income of $30,000) will face somewhat greater tax burdens than before. In addition, the tax changes have long-run distributional effects that are not adequately captured by simply looking at the point-in-time impact across income levels, a subject we will discuss later.

A Closer Look at the Outlay Side

Like the Clinton plan before it, OBRA93 seeks simultaneously to reduce total federal outlays and to shift spending priorities (see figure 3). Assuming that planned defense cuts follow the proposals in Vision, total outlays for nondefense discretionary spending will, relative to the old status quo, be higher in all years but FY1998. However, over five years, the legislation calls for a nearly $70 billion decline in overall discretionary expenditures, a total guaranteed by legislated spending caps that are binding unless specifically abrogated by acts of Congress.

The balance of OBRA93’s $192 billion spending reductions stems from a decline in planned mandatory and interest expenditures. These changes — particularly in mandatory spending — have a significant impact on the generational burden of the plan, an issue to which we now turn.
Lifetime Tax Rates

Table 2 presents lifetime tax rates under both baseline and OBRA93 policies. The table indicates a consistent increase over time: Generations born in the early 1900s faced lifetime tax rates in the range of 20 to 25 percent of lifetime labor earnings, while generations born in the 1990s, if treated as indicated under baseline policies, would face rates just under 34 percent. Most disturbing, however, is the fact that under baseline policies, generations born after 1991 are estimated to face lifetime tax rates of more than 70 percent, on average. This severe imbalance in the status quo fiscal policy reflects a surge in projected entitlement spending by way of Social Security, Medicare, and Medicaid, together with an increase in the number of elderly recipients of these benefits.

Table 2 also illustrates our earlier observation that the generational effects of the proposals presented in Vision were not changed significantly by the various modifications that yielded OBRA93. Like the initial plan, the final legislation imposes fairly modest increases in the lifetime tax rates on most living generations. The largest increases are imposed on the relatively younger generations. This is not surprising, because these individuals have the greater part of their earning and tax-paying years ahead of them and will therefore pay higher taxes for a longer period of time. Despite the small rise in tax rates implied by the tax and spending changes in OBRA93, the reduction in the average lifetime tax rate faced by future generations is a sizable 13 percent. The new lifetime tax rate of future generations is still quite large, however, meaning that OBRA93, like the Clinton plan before it, represents only a small step toward equalizing the lifetime tax burdens of living and future generations.

Per Capita Tax and Transfer Flows — FY1994-98

The assumption that the policies embodied in OBRA93 will be in force permanently is an extreme one, and changes are certain to occur in the course of future policy. Consequently, it is perhaps
Deja Vu All Over Again? During the Bush administration, Congress passed the Omnibus Reconciliation Act of 1990 (OBRA90), legislation that proposed a five-year deficit reduction of about $500 billion, raised fuel taxes by about a nickel per gallon, increased marginal tax rates on high-income individuals, placed caps on discretionary spending, and restricted Medicare outlays, among other things. The deficit—in nominal terms, in real terms, and relative to GDP—rose in each of the two fiscal years following OBRA90’s passage. The CBO’s projections as of August put the FY 1993 deficit at about $266 billion, nearly $40 billion higher than the FY 1990 deficit, and still a larger percentage of GDP than prevailed at the time OBRA90 was signed into law.

Many economists and policymakers point to extraordinary factors—presumably unrelated to the provisions of the budget bill itself—that have unfortunately conspired against the progress toward deficit reduction for which the proponents of OBRA90 had hoped. Chief among these are the recession that began in the summer of 1990 and the unusually slow recovery that followed.

higher taxation of Social Security beneficiaries translates into sizable increases in the net tax burdens per capita for older male and female generations, while higher income taxes impose significant burdens on young and middle-aged male generations.

On a per capita basis, these tax and transfer changes suggest that per capita increases in burdens are larger for older individuals. However, to the extent that policies under OBRA93 are continued beyond 1998—and in view of the pressures for higher taxes that will undoubtedly emerge as a result of the imbalance in the nation’s fiscal policies—young and middle-aged generations are likely to face future tax burdens that are much larger than those indicated in the figures.

more instructive to consider the generational impact of OBRA93 only up to the last year that the legislation is in force (1998). We now shift our focus from lifetime tax rates to estimates of the annual per capita taxes and transfers implied by the legislation over the next several years.

Figures 4 and 5 depict the change in annual payments for the most important categories of taxes and transfers for selected generations from FY 1994 through FY 1998. The data confirm the earlier discussion that most of the cuts are to occur in FY 1997–98. The reductions in health benefits and the
An alternative explanation, however, appeals to traditional supply-side criticisms of raising marginal tax rates to combat deficits. The essence of these arguments is that the failure of government estimates to incorporate behavioral responses to tax changes causes official revenue projections to be grossly overstated. For instance, economists Martin Feldstein and Daniel Feenberg estimate that tax avoidance in the face of OBRA93's tax rate increases will cause income tax revenues to be about $20 billion less than the administration has claimed. Preliminary calculations performed by the Federal Reserve Bank of Cleveland’s research staff suggest that labor supply and saving responses could result in shortfalls of a similar magnitude.

In fact, the post–OBRA90 period provides something of a natural experiment for these supply-side arguments, and the evidence is not encouraging for deficit reduction prospects. Federal tax revenues in 1991 and 1992 were more than $130 billion less than the CBO initially projected following passage of that legislation, and less than 60 percent of this shortfall can be directly accounted for by changing economic conditions. Given the striking similarities between OBRA93 and OBRA90, the prospects for real deficit reduction, as well as increased generational equity, critically depend on whether the supply-side or extraordinary-factor interpretation of OBRA90’s failure is correct.
Footnotes


2. The generational accounting results reported here are based on Mid-Session Review of the 1994 Budget, Office of Management and Budget, September 1993.

3. We present a more detailed discussion of differences in the CBO and OMB calculations in our earlier article.

4. OBRA93 specifies spending caps for total discretionary outlays, but does not indicate separate mandatory limits for defense and nondefense components. Subject to revisions for economic and technical reasons or mitigating legislation in Congress, defense expenditures that are higher than those indicated here would necessarily be met by lower nondefense outlays.

5. The baseline lifetime tax rates are taken from Budget Baselines, Historical Data, and Alternatives for the Future, Office of Management and Budget, January 1993.

6. The lifetime tax rates presented are the ratios of lifetime net tax payments to lifetime labor income. Capital gains in excess of the normal return on saving and net transfers from other generations are not included in our calculations because of data limitations. However, the upward bias in the reported tax rates resulting from these omissions is minimal because these sources of income constitute only a small fraction of lifetime resources. The lifetime tax rates reported are population-weighted averages over male and female generations of the same age.

7. The smaller tax hikes and greater spending reductions under OBRA93 result in lifetime tax rates that are marginally lower for all (living and future) generations relative to those implied by proposals in Vision.

8. Only changes in tax and transfer payments are shown. Changes in government purchases of goods and services are not included in the analysis. This exercise can be viewed as an answer to the question, "What is the marginal change in the distribution of the burden of paying for government purchases?"


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The views stated herein are those of the authors and not necessarily those of the Federal Reserve Bank of Cleveland or of the Board of Governors of the Federal Reserve System.