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The Gramm-Rudman-Hollings Act:
More Revisions?

by

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The Gramm-Rudman-Hollings Act: More Revisions?

During the first half of the eighties, the U.S. federal deficit rose from \$ 74 bn to \$ 212 bn. When the Congressional Budget Office (CBO) projected in August 1985 that the deficit would further increase to \$ 285 bn by 1990, the Gramm-Rudman-Hollings Act (GRH Act) was put into law.¹ Its purpose is to help the government with cutting the deficit, even more, to force it into doing so. Congress and the president put themselves into this confined situation by voting for and signing the bill, respectively, because they realized that their differences in budget priorities would continue to cause budget deadlocks. The GRH Act specifies deficit targets for each year which decline at equal steps to reach zero in the final year, which is now supposed to be 1993. There have been deficit targets before, but they were regularly passed over in the budget process. This is not possible now, because the sequestration procedure, the prominent feature of the GRH Act, requires that federal government expenditures - on defense and nondefense likewise - be cut "automatically" if the regular budget process does not reduce the federal budget deficit to the specified amount.

The GRH Act which has given rise to much discussion has now been in effect for over four years. During that time, it has been revised once, and another revision is presently being considered. This paper is an attempt to evaluate the GRH Act. First the development which led to the law will be briefly reviewed. Then the idea of the law will be discussed, including the question whether the deficit concept used is correct. Finally, the experience with the GRH Act will be discussed as well as the possibility of another revision.

Developments Leading to the Gramm-Rudman-Hollings Act

The GRH Act was not the first budget act that was put into law out of fear that the federal budget deficit was getting out of control. In 1921, the Budget and Accounting Act was created in response to a series of deficits, exacerbated by World War I.² With this act Congress delegated power over the budget to the president, in particular, the right to initiate the budget, hoping that this would make the budget process more efficient.³ During the following quarter century, the budget was still in deficit, mainly because of the two World Wars and the Great Depression, but in the subsequent years it generally was in surplus. The Budget Act of 1921 was kept until the mid-seventies. At the beginning of the seventies, Congress and President Nixon got into a major dispute when the president used the right to freeze funds (impoundment) to prevent expenditures which Congress had approved against his will. As a consequence, Congress made a new law, the Budget and Impoundment Control Act of 1974. This act did not only limit the president's power to freeze funds, it also served Congress to retrieve several other rights over the budget it had previously delegated to the president.⁴

One major goal of the new budget law, to curb the rise in federal expenditures permanently, was not achieved mainly for two reasons. First, each government agency was trying to move more and more expenditures off budget, which meant that these expenditures were no longer under the control of the appropriation committees.⁵ Second, social security expenditures were increased considerably during the seventies and eighties, among others as a consequence of the indexation and the population growth.⁶ This did not lead to an increase in the general level of expenditures at first, because growth in defense expenditures slowed down noticeably during the early seventies. But later in the decade (thus still under the Carter Administration) and during the first half of the eighties, defense spending rose considerably, and so did total expenditures.

In 1981, considerable tax cuts were put into law.⁷ It was first expected that these measures would stimulate working efforts and growth and would thereby increase tax income. Instead, tax revenues increased considerably slower than before. This was exacerbated by the recession of 1980-82, which also led to additional expenditures. As a consequence of these developments, the federal budget deficit increased at the beginning of the eighties. Congress continued to reject cuts of social security benefits and the president did neither approve decreases in defense spending nor a rise in tax rates. In every year after 1981, the president's budget proposal was declared dead on arrival; i.e., Congress did not use it for its budget planning.⁸

In view of these problems, the decision-making process used for preparing the budget came under much criticism. It was argued that this process was not conducive to cutting the deficit, because congressmen, who in principle might favor a reduction of the deficit, had to secure certain projects in order to be reelected. This would lead to the tendency to form coalitions in which every one would vote for the other congressmen's favorite project in exchange for their vote on his favorite project (logrolling), the result being a higher expenditure level than what would have been optimal. This view led to the conclusion that the fiscal process had to be subjected to rules valid in the long run.⁹ The GRH Act was the first attempt to apply this idea. After a Senate proposal to stop indexation of social security benefits for one year, to freeze real defense expenditures, and to increase taxes had been rejected in spring 1985, the GRH Act was proposed by the Senate in the following summer.¹⁰ To assure its acceptance, the act was added to a bill to authorize an increase in the debt ceiling (from \$ 1824 bn to \$ 2078 bn) which was unlikely to be rejected. In effect, after a couple of changes had been made, the Balanced Budget and Emergency Deficit Control Act, in short, the Gramm-Rudman-Hollings Act¹¹, was put into law and was signed by the president on December 13, 1985.

As expected by many from the beginning, the GRH Act was ruled unconstitutional by the Supreme Court in 1986, the reason being that the General Accounting Office (GAO) which was dependent on Congress transmitted the necessary expenditure cuts to the president. This violated the division of powers. The revision of the GRH Act which followed this ruling in 1987 was used to raise at the same time the deficit ceilings, because it was recognized that it would be very difficult to bring the deficit below the required limit.¹²

The major provisions of the GRH Act of 1987

- The GRH Act prescribes deficit ceilings for the federal budget which decline by \$ 36 bn from year to year to reach zero in the final year, which is now 1993; according to the law of 1985, it was 1991 (Table 1).¹³

Table 1 - Federal Deficit and GRH-Ceilings (Billion Dollars¹)

Fiscal Year	Deficit	Deficit Ceilings of	
		1985	1987
1970-74	14.0 ²	-	-
1975-79	56.5 ²	-	-
1980-84	134.7 ²	-	-
1985	212.3	-	-
1986	221.2	171.9	-
1987	149.7	144.0	-
1988	155.1	108.0	144.0
1989	152.0	72.0	136.0
1990	-	36.0	100.0
1991	-	0	64.0
1992	-	-	28.0
1993	-	-	0

¹Current Prices.- ²Average.

Source: Council of Economic Advisers, Economic Report of the President. Washington 1989. - United States Senate, Committee on the Budget, Gramm-Rudman-Hollings and the Congressional Budget Process. Washington 1986.

- The president is obliged to heed the respective limits, when making his budget proposal at the beginning of each year for the following fiscal year (starting October 1).
- When the budget process conducted until August results in a projected deficit for the following fiscal year that exceeds the ceiling by more than \$ 10 bn, then expenditures that have not been explicitly exempted are cut in order to bring the deficit down to the admissible amount. The cuts are equally distributed over defense and nondefense expenditures.
- The OMB estimates the necessary cuts and transmits them to the President. (In the 1985 Act, both the OMB and the CBO had to make the required estimations which they gave to the GAO, in a joint report. The GAO checked them and, if necessary, made a few changes, before transmitting its own report to the president).
- In case an agreement is reached between Congress and the president to cut the deficit using alternative measures as, for example, an increase in taxes or a cut in other expenditures, then the sequestration procedure is not followed. If such an alternative solution is not found by October 15, the across-the-board cut, based on the updated OMB estimates, takes place.
- There are exceptions from this rule in case of war or in case of a recession. The case for a recession is given if either the OMB predicts two consecutive quarters of real growth less than or equal to zero or if the Department of Commerce publishes rates below 1 p.c. for the preceding two quarters.

The Deficit Concept

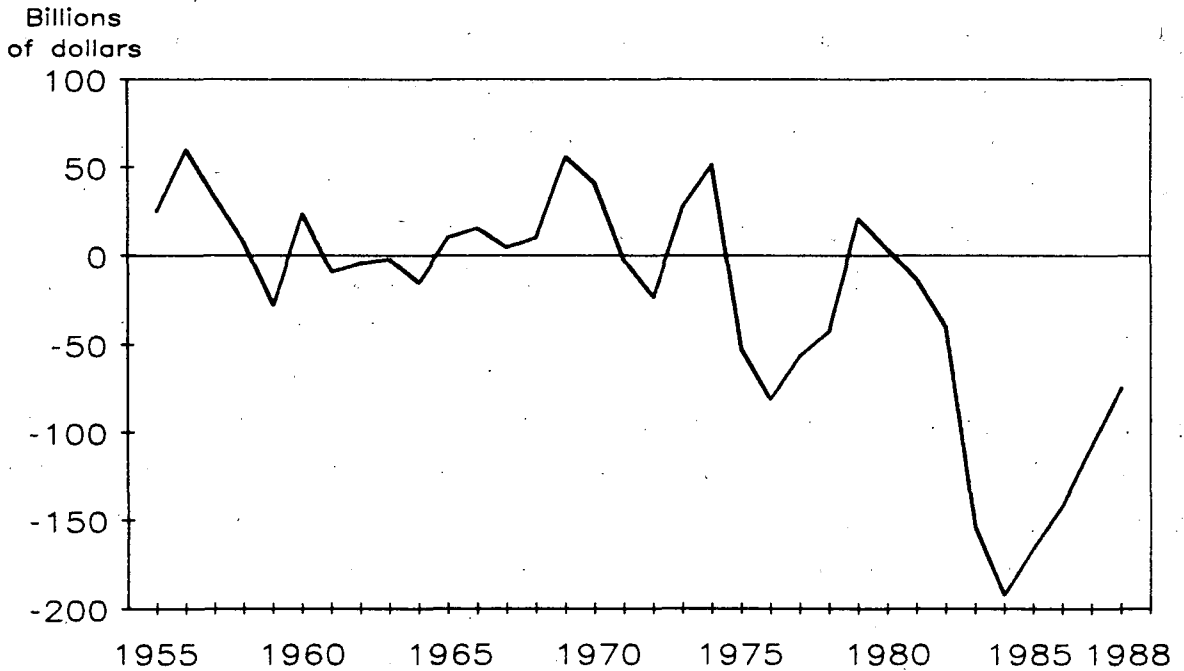
The idea behind the GRH Act is that the federal deficit is too high and should be cut down to zero. To prove that it is too high, generally the official deficit numbers are used and it is

argued that they have reached record levels. Indeed, in 1985, when the GRH Act was created, the deficit was four times as high as in wartime-1943 when the deficit amounted to \$ 54.6 bn, which remained the record level until 1975. However, an increasing deficit and an increasing government debt alone does not necessarily seem worrisome if the economy is growing.

One step in the right direction is to look at the deficit in relation to gross national product. According to this concept, in view of the increase in nominal GNP from roughly \$ 2000 bn to \$ 4000 bn as it was observed from 1977 to 1985, a doubling of the deficit during the same time would seem normal. Actually, the deficit has quadrupled during this period. This makes the deficit quota of the eighties relatively high for peacetime. However, although the deficit quota does consider the fact that due to inflation a certain deficit or GNP is not valued as much today as it would have been some time ago, it does not take into account that inflation erodes the federal debt. Thus, a period of high inflation does not only lead to high expenditures, particularly, high interest payments, it also devalues the current federal debt. To take care of this effect we have to look at an adjusted deficit or else at the debt in relation to GNP.¹⁴ But according to these measures, too, the deficit was relatively high during the mid eighties.

Furthermore, even looking at the ratio of the inflation-adjusted deficit to GNP does not consider the effect the business cycle has on the deficit. In a recession, not only do expenditures rise more than usual and revenues increase less than usual, but in addition, the GNP declines which together makes the deficit ratio rise. Clearly, the business cycle argument would help to discount the high deficits during the recessionary period from 1980 to 1982. However, it does not explain why the deficits kept rising after the economy started booming in the following years. But even a deficit measure that is not only inflation-adjusted but also adjusted for the business cycle does yield the result that the US federal budget deficit was exceptionally high during the mid eighties (Fig. 1).¹⁵

Figure 1 - The Cyclically and Inflation-Adjusted Deficit



Source: Council of Economic Advisers, Economic Report of the President. Washington 1989. - Federal Reserve Bank of St. Louis, Monetary Trends, var. issues. - Department of Commerce, Survey of Current Business. Washington, July 1987. - Own calculations.

Hence, it can be summarized that alternative measures lead to the same conclusion as traditional deficit measures, which is that in 1985 the deficit was at an unusually high level for historical standards. If we consider, that high deficits place a burden on future generations, given that they are not compensated fully by higher private saving, the intention of the GRH Act, to reduce the deficit seems justified.¹⁶ However, it is not immediately plausible why the deficit in the special definition (which has flaws) should be reduced to zero. Why, for example, should the government have a balanced budget if its net investment, leading to benefits in future periods, is positive?¹⁷

As far as the rule is concerned to cut the deficit by \$ 36 bn year over year, at first sight it seems to make sense to have such a stable and predictable rule. However, a problem arises from the fact that the deficit measure used here is the offi-

cial measure which neither takes into account inflation nor growth nor the business cycle. What effect this has with regard to the business cycle is quite obvious. During a period of strong growth, due to higher tax revenues and lower unemployment expenditures, the deficit tends to decrease. Hence, in order to obtain a deficit which is \$ 36 bn lower than the previous year's level, that part of the deficit which is independent of the business cycle will have to be cut by less than \$ 36 bn. This means that the GRH Act requires a smaller exogenous deficit cut with strong than with weak growth, implying that the GRH Act has a procyclical effect. It works contrary to the desired anticyclical effect of the economy's built-in stabilizers (unemployment insurance, progressive tax system).¹⁸ It would have been possible to avoid this procyclical effect by designing the act in such a way that declining limits would have been applied to an adjusted deficit measure or a certain expenditure quota - better even a quota of a cyclically adjusted expenditure relative to trend GRH - would have been required. The major argument against such a solution was that it would make the sequestration process even more complicated and less predictable.

Experiences with the GRH Act

Originally, it was planned to apply the automatic expenditure cuts to a very broad level of programs. This would have limited the effect a cut would have on a single program. However, as a result of the pressure of interest groups, several programs were exempted from the automatic cuts. This had the effect that the remaining programs now have to bear a relatively large burden of each cut. This makes each across-the-board expenditure cut seem more undesirable than otherwise and it increases the pressure to find an alternative solution avoiding the sequestration.

Optimistic Forecasts - Means to Avoid the Sequestration?

The GRH Act requires that expenditure cuts be determined before the fiscal year begins.¹⁹ Therefore, revenues and expenditures of the coming year have to be estimated. They usually are based on projections concerning the economic development, which are, of course, subject to great uncertainty. Clearly, the more optimistic an economic forecast, the lower the deficit projection, and the lower the required deficit cut. This relation has led to the widely accepted view that the GRH Act must have increased the tendency of government agencies, in particular the OMB, to make optimistic projections in order to avoid deep expenditure cuts which might in turn bring about a recession. This idea is based on the contention that politicians always take into account their chances of being reelected when making their decisions, and these chances are generally lower after a recession.

If the forecasting errors of the OMB are analyzed for the period from 1977 to 1989, it is clear that the OMB has on average overestimated the real growth rate by more than one percentage point (Table 2).²⁰ This exceeds the average prediction error made by the CBO and private forecasters.²¹ On the other hand, the OMB's predictions for the inflation and unemployment rates have been somewhat more accurate than that of the other predictors. In order to check the contention that the GRH Act has caused the OMB to overestimate the economic performance, the focus should be merely on the predictions for the previous three years, because the GRH Act was signed in 1985 and the first forecast under the new law was the one made at the beginning of 1986 for 1987. Surprisingly, the OMB's forecasting error is not only smaller than the average forecasting error for the whole period, it is even negative. Admittedly, the result might have to do with the fact that the last three years were years of strong growth, whereas generally the estimation errors are highest during turning points of the business cycle (Fig.2).²² But up to this moment, it has to be concluded that the argument that the OMB tends to overestimate growth in order

Table 2 - Prediction Errors for Changes in U.S. Real GNP and GNP-Deflator and for U.S. Unemployment Rates¹

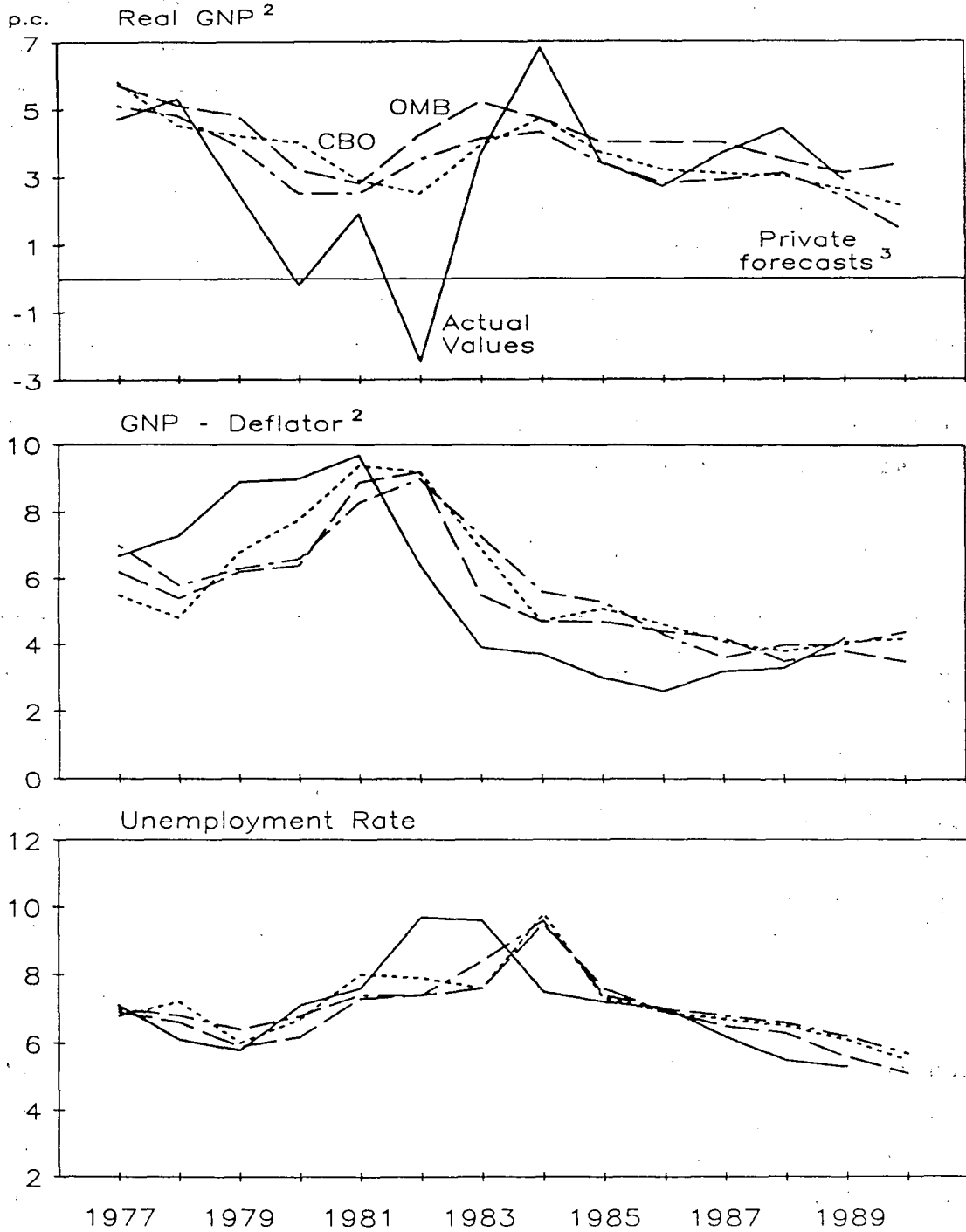
	Gross National Product			GNP-Deflator			Unemployment Rate		
	OMB ²	CBO ³	Private Forecasts ⁴	OMB	CBO	Private Forecasts	OMB	CBO	Private Forecasts
Mean Average Error ⁵	1.16 (-0.13)	0.68 (-0.77)	0.47 (-0.87)	0.09 (0.27)	0.38 (0.43)	0.40 (0.30)	-0.11 (0.47)	0.14 (0.77)	0.16 (0.87)
Mean Absolute Error ⁶	1.65 (0.47)	1.48 (0.77)	1.33 (0.87)	1.46 (0.53)	1.51 (0.50)	1.65 (0.43)	0.78 (0.47)	0.84 (0.77)	0.79 (0.87)
Mean Square Error ⁷	2.38 (0.56)	2.06 (0.90)	2.06 (0.93)	1.69 (0.63)	1.77 (0.60)	1.91 (0.48)	1.09 (0.52)	1.11 (0.79)	1.06 (0.89)

¹Yearly average.- ²Office of Management and Budget.- ³Congressional Budget Office.- ⁴Average of private forecasts.- ⁵ Σ (Forecast-actual value)/number of observations. Numbers in brackets refer to the period 1987 to 1989.- ⁶ Σ |Forecast-actual value|/number of observations.- ⁷ Σ (Forecast-actual value)²/number of observations.

Source: James A. Howard, Government Economic Projections: A Comparison Between CBO and OMB Forecasts, *ibid*, for the projections of OMB and CBO prior to 1986.- Office of Management and Budget, *The Budget of the United States*, Washington, 1989.- Congressional Budget Office, *The Economic and Budget Outlook*, Washington, *var. issues*.- The Conference Board Statistical Bulletin, New York, *var. issues*.- Own calculations.

to avoid large budget cuts cannot be confirmed by the available data. Similarly is the average prediction error of the unemployment rate higher and positive for the last three years rather than lower which we would expect from a forecast intended to keep expenditure cuts low. The average inflation projection error is only slightly higher for 1987-1989 than for the whole period considered, and it is not clear whether this would serve to minimize automatic cuts, given on one hand higher tax revenues but on the other hand higher interest payments and other expenditures.

Figure 2 - Projected and Actual Unemployment Rates and Changes in Real GNP and GNP-Deflator ¹



¹ Forecasts made at the beginning of the year for the following year, respectively.- ² Percentage changes.- ³ Published by the conference Board.

Source: Office of Management and Budget, The Budget of the United States, Washington 1976-1989. - Congress of the United States, Congressional Budget Office, The Economic and Budget Outlook. Washington 1976-1989. - The Conference Board, Statistical Bulletin. New York, February 1976-1989.

Measures to Reduce the Budget Deficit

The GRH Act focuses on the unified budget, not merely at expenditures and revenues that are on-budget. This has stopped the trend of moving more and more expenditures off budget in order to escape regular budget control and to keep the official budget figures low. Recently, off-budget expenditures as a share of total expenditures declined after having risen for several decades (Table 3). However, there are still possibilities to move expenditures off the unified budget, and other methods to decrease the official deficit measure have either been used more intensively or have been discovered since the GRH Act was put into law. A close look at the previous years' budget decisions reveals such measures.

Table 3 - Federal On-Budget and Off-Budget Outlays

	1950 ¹	1955	1960	1965	1970	1975	1980	1985	1987	1989
On-budget outlays	98.6	94.3	88.2	86.0	85.9	81.8	80.7	80.5	80.7	81.5
Off-budget outlays	1.4	5.7	11.8	14.0	14.1	18.2	19.3	19.5	19.3	18.5

¹Fiscal years.

Source: Council of Economic Advisers, Report of the President, Washington 1989.- Own calculations.

The GRH Act was signed in December 1985, when fiscal year 1986 (running from October 1, 1985 to September 30, 1986) already had started. For this reason the maximum amount of automatic cuts was restricted to \$ 11.7 billion, which was exactly the amount by which total expenditures were eventually cut as the president and Congress could not come to an agreement about alternative measures to reduce the deficit;²³ the resulting deficit was \$ 221 billion. Starting fiscal year 1987, such measures were found.²⁴ Despite the fact that the GRH Act was declared unconstitutional and did not pose a threat anymore as fiscal year 1987 approached, the decision was made to cut the

deficit by \$ 31 billion to the estimated value of \$ 151 billion, just below the maximum admissible amount of \$ 154 billion (including an error margin of \$ 10 billion). However, these cuts included \$ 8 billion of asset sales, \$ 10 billion of additional tax revenues due to an increase in the capital gains tax which were matched by lower tax revenues in future years, and \$ 3 billion of one-time savings due to a deferral of a military pay raise from September 30 to October 1.²⁵ Thus less than half of the \$ 31 billion deficit cut in 1987 consisted of permanent savings, and the decline in the federal deficit from \$ 221 billion in 1986 to \$ 150 billion in 1987 was mainly due to the good economic development and these one-time savings.

For the budget of 1988, the deficit limit was \$ 144 billion according to the revised GRH Act, instead of \$ 108 billion as required by the original law. The new law exempted various transactions as, for example, asset sales from counting towards the GRH reduction. Nevertheless, the agreement to cut the budget deficit by \$ 33 billion reached in December 1987 following the stock market crash included \$ 8 billion of asset sales as well as one-time savings due to a change in tax collection dates. (The deficit eventually came to \$ 155 billion.) At the same time, it was agreed to reduce the 1989 budget deficit by \$ 46 billion; this decision was subsequently incorporated in the president's budget proposal for 1989. The budget cut - later reduced to roughly \$ 33 billion - was to be reached through higher tax revenues in the order of \$ 14 billion and reductions both in military and nonmilitary spending.²⁶ As it became clear in the course of the budget year that the strong economy would lead to a greater deficit reduction than expected, an additional bill was passed to include \$ 20 billion to be spent on the ailing savings and loan industry; these expenditures had originally been located outside the budget. As a consequence, the actual deficit in fiscal year 1989 amounted to \$ 152 billion and thus exceeded the admissible limit. This was possible, because, according to the GRH Act, the automatic across-the-board cut is only triggered at the beginning of the fiscal year, not during the year.

For fiscal year 1990 an agreement was reached in April 1989 to cut the deficit by \$ 28 billion so as to push it below the admissible GRH limit of \$ 108 billion (excluding the \$ 10 billion error margin). Again, this incorporates one-time savings as, for example, an earlier collection of firms' social security contributions and the exclusion of the deficitary postal budget from the federal budget. Furthermore, expenditures in connection with the bailout of the savings and loans industry amounting to \$ 30 billion were not put on the official budget and therefore do not count towards the deficit. Finally, notwithstanding the OMB's accurate growth projections of previous years, there is reason to believe that the forecast of 2.6 percent real growth for the current year is somewhat too optimistic, the OMB itself has already raised its deficit projection to \$ 124 billion.

Another Revision of the GRH Act?

Recently it has been discussed to revise the GRH Act once more. In particular, due to the current weakness of the economy as well as high costs involved in the bailout of the savings and loans industry, it is to be doubted that the GRH limits for the coming years, starting with \$ 64 billion in fiscal year 1991, can be met, despite the growing surplus in the social security system. (The latter has attracted much attention during the last couple of months due to senator Moynihan's proposal to lower social security tax rates.) Therefore, it has been suggested to increase the deficit limits one more time, possibly in connection with a stricter regulation as to what can count towards a deficit reduction. However, a further revision of the GRH Act might well lower the credibility of US fiscal policy which has already suffered from the first revision and the various one-time savings measures. Therefore, it has to be ensured that the new GRH Act would be effective enough to outweigh these credibility problems.

As to the effectiveness of the law until now, it is clear that the reduction of the federal budget deficit from \$ 221 billion in 1986 to \$ 152 billion in 1989 can barely be attributed to the GRH Act. First of all, the economic activity was strong in recent years. According to the National Income and Product Accounts, the deficit (defined slightly differently from the usual measure) has declined by roughly \$ 70 billion within the same time span; however, when cyclical effects are taken into account, the remaining deficit reduction only came to \$ 20 billion.²⁷ Secondly, during this period the surplus of the social security system which is presently included in the unified budget increased from \$ 9 billion to \$ 56 billion, thus bringing the deficit down.²⁸ On the other hand, it has to be remembered that the CBO projected in 1985 that with current law the deficit would increase to \$ 285 billion in 1990, not stay at the same level. This projection did also include the increase in the social security surplus, and the underlying economic forecasts turned out to be quite accurate. Furthermore, the share of government expenditures in GNP, which had been rising for long, has declined in recent years. Hence, the GRH Act has had some, even if quite limited success.

As far as the credibility of fiscal policy is concerned, it has suffered considerably from the fact that the GRH Act was barely able to induce politicians to make sensible and far-reaching expenditure cuts. Budget decisions were made with the intention to reduce the deficit below a certain limit, often ignoring the economics involved in these decisions. This and the revision of the law in 1987 have created much uncertainty in recent years, contrary to what one would expect from a fiscal policy which is conducted according to a certain rule. Such uncertainty is not a good environment for saving, investment, and growth in general. It can also cause international investors to request a higher risk premium, hence raising the US interest level.

If the GRH Act should be revised one more time, it is not sufficient to raise the deficit limits. Instead, there should be stricter rules as to what can count toward the deficit re-

duction and there should be a mechanism that cuts expenditures to a certain extent in the course of the year in case the deficit turns out to be much higher than projected at the beginning of the fiscal year. Furthermore, it would be desirable, even if slightly more complicated, to apply a rule of declining deficits to a cyclically and inflation-adjusted deficit measure. Finally, if the steps of \$ 36 billion seem to be too wide, once one-time savings measures are disallowed and once the social security system is excluded from the budget (if that happens at all), it seems wiser to reduce the required reductions from year to year right away than risking another revision of the law. Should a far-reaching revision of the GRH Act not be politically feasible, it might well be advisable to abandon the law altogether.

Notes

- 1 For the projections cf. Congress of the United States, Congressional Budget Office, The Economic and Budget Outlook: An Update. Washington, August 1985.
- 2 Cf. Howard E. Shuman, Politics and the Budget. 2nd. ed., Englewood Cliffs, 1988, ch. 2.
- 3 At the same time, the Bureau of the Budget (after 1970 the Office of Management and Budget = OMB) was created as arm of the executive and the General Accounting Office (GAO) as arm of the legislative, and the president was requested to submit a budget proposal to Congress each year.
- 4 In addition, the new reconciliation procedure guaranteed that the level of expenditures and revenues agreed upon by the budget committees be equal to the sums of expenditures and revenues, respectively, determined by the different appropriation committees. Cf. Senate of the United States, Committee on the Budget, Gramm-Rudman-Hollings and the Congressional Budget Process. Washington 1988.
- 5 Cf. John M. Palfy, "The Congressional Budget Process." Mandate for Leadership, Washington 1984, pp. 387-401.
- 6 Cf. Harry S. Havens, "Gramm-Rudman-Hollings: Origins." Public Budgeting and Finance, Vol. 6, New Brunswick 1986, No. 3, pp. 4-24.
- 7 For a discussion of the changes in economic policy under Reagan see Michael Boskin, Reagan and the U.S. Economy. San Francisco 1987.
- 8 Cf. David G. Mathiasen, "The Evolution of the Office of Management and Budget Under President Reagan." Public Bud-

geting and Finance, Vol. 8, *ibid*, 1988, No. 3, pp. 3-14.

9 For a general discussion cf. James M. Buchanan, *The Limits of Liberty*. Chicago 1975.

10 Meanwhile, the public had become troubled by the increased federal budget deficit and the federal debt that had doubled from 1981 to 1985 and had been putting pressure on congress-man. Cf. Steven M. Sheffrin, "Fiscal Policy Tied to the Mast: What Has Gramm-Rudman Wrought?" *Contemporary Policy Issues*, Vol. 5, Huntington Beach, Calif., 1987, No. 2, pp. 44-56.

11 After the Republican senators Phil Gramm and Warren Rudman and the Democratic senator Fritz Hollings.

12 For a discussion of the changes compared to the law of 1985 see Havens, *ibid*, and Lance T. LeLoup and John Hancock, "Congress and the Reagan Budgets: An Assessment." *Public Budgeting and Finance*, Vol. 8, *ibid*, 1988, No. 3, pp. 30-54.

13 For several years there were exceptions. For example, in fiscal year 1986 the reduction was limited to \$ 11.7 billion.

14 Cf. Robert Eisner, *How Real is the Deficit?* The Free Press, New York 1986, and Robert J. Barro, *Macroeconomics*. 2nd. ed., New York 1987.

15 Such a deficit measure is obtained by computing the increase in the deflated, cyclically adjusted end-of-the-year public debt, the appropriate deflator being the corresponding fourth quarter GNP-deflator. Cf. Barbara Kauffmann and Joachim Scheide, "Die amerikanischen Defizite im Kreuzfeuer der Kritik." Kiel Discussion Paper No. 150. Kiel 1990.

- 16 Wilcox concluded in his study that US fiscal policy between 1974 and 1984 was not sustainable. Cf. David W. Wilcox, "The Sustainability of Government Deficits: Implications of the Present-Value Borrowing Constraint." *Journal of Money, Credit and Banking*, Vol. 21, Columbus, Ohio, 1989, No. 3, pp. 291-306.
- 17 In the provisional constitution (Grundgesetz) of the German Federal Republic, for example, there is the rule that the federal deficit should generally not exceed the government's net investment.
- 18 In principle, this procyclical effect can even be enlarged by too pessimistic projections concerning the economic strength during a phase of weak growth or too optimistic projections during a period of strong growth.
- 19 To be exact, cuts in budget authority have to be determined that lead in turn to decreases in budget outlays. The relation between the two is close, but not completely stable.
- 20 Cf. James A. Howard, "Government Economic Projections: A Comparison Between CBO and OMB Forecasts." *Public Budgeting and Finance*, Vol. 7, *ibid*, 1987, No. 3, pp. 14-25; Michael T. Belongia, "Are Economic Forecasts by Government Agencies Biased? Accurate?" *The Federal Reserve Bank of St. Louis, Review*, Vol. 70, 1988, No. 6, pp. 15-23; George A. Plesko, "The Accuracy of Government Forecasts and Budget Projections." *National Tax Journal*, Vol. 16, Columbus, Ohio, 1988, No. 4, pp. 483-501.
- 21 These are the U.C.L.A. Business Forecasting Project, Merrill Lynch Economic Inc., E.I. du Pont de Nemours & Co., Georgia State University, The Conference Board, Laurence H. Meyer Associates, Inc., Data Resources Inc., Wharton E.F.A., Inc., whose forecasts were published by the Conference Board. Cf. The Conference Board, *Statistical Bulletin*. New York, February 1976-1989. However, not all institutes' fore-

casts were included from the beginning of the period considered here.

- 22 Cf. Victor Zarnowitz, "On the Accuracy and Properties of Recent Macroeconomic Forecasts". *American Economic Review*, Menasha, May 1978, pp. 313-321.
- 23 For a detailed description of this sequestration process cf. Havens, *ibid*, p. 10.
- 24 Cf. *The Economist*, "The budget - Unhappy new year". London, September 27, 1986.
- 25 The former CBO director called this last type of measure "creative timing change"; cf. Rudolph Penner, "On the Budget Process." *Contemporary Policy Issues*, Vol. 6, *ibid.*, 1988, No. 4, pp. 32-36.
- 26 Cf. *Data Resources*, *Review of the U.S. Economy*, *ibid*, January 1988, and Martin Feldstein, "Budget Card Tricks and Dollar Levitation". *The Wall Street Journal*, Brussels, December 2, 1987.
- 27 The NIPA measures are published by the Federal Reserve Bank of St. Louis in "Monetary Trends".
- 28 Cf. Council of Economic Advisers, *Economic Report of the President*. Washington 1989.