

## **BUDGET RULES**

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People tend to expect both too much and too little of budget rules. Because they are more art (or perhaps, craft) than science, it is impossible to derive some ideal set of rules through theory. Because they involve many arbitrary elements, they are also easy to disparage. And yet, an orderly decision process requires rules, written or unwritten.

We believe that the return of significant deficits after a brief interlude of surpluses will make it inevitable that budget policy will be a prime focus of attention in 2005 or soon thereafter, and that budget rules will receive a significant share of that attention. This article represents an attempt to make some sense out of budget rules and what we might expect from them.

Budget rules can be likened to the rules by which a household conducts its financial affairs. No matter how formal or informal, they cannot force rational budget decisions if the parties to the agreement do not want to be rational. By the same token, once there is a political consensus behind a specific goal, like balancing the budget, rules can limit the extent to which the Congress strays from that goal. They can keep nudging legislators in the right direction, even if they do not always prevent moves in the wrong direction. They can also provide a handy excuse when a legislator is forced to make an unpopular decision. A politician can say that he or she would love to give a tax break to a certain industry, but the rules forbid it.

Rules may not by themselves force action, but they can have a powerful effect on the types of actions taken. No piece of legislation is drafted without some set of rules,

implicit or explicit, as to what will be contained in it and what will not. There are one-time budget rules, like reducing the size of the cumulative deficit over 5 years by \$500 billion. That was the budget target for both the 1990 and 1993 budget agreements. The Tax Reform legislation of 1986 had to be “deficit-neutral and revenue-neutral” , and “75-year trust fund balance of roughly zero” was the goal of the 1983 Social Security reform. One-time rules are often, simply agreed to by the leadership. Then there are rules that are meant to apply over time, such as “pay-as-you-go (PAYGO)” and the “Byrd rule” applying to long-term changes in the deficit (see discussion below).

*Budget rules are frequently associated with numerical targets, such as a zero change in the deficit in any bill enacted over a given period (PAYGO).* That these rules have a powerful impact on policy is reflected in the fact that almost all major legislation in recent years has been crafted and restricted under both one-time and more extended rules. Even in recent years, when budget discipline eroded badly, the so-called Byrd rule prevented reconciliation bills from increasing deficits after the end of the budget horizon used in the budget resolution. Often legislation will be crafted under both ongoing budget rules and one-time targets adopted for particular legislation. Thus, Congress in 1993 utilized the 1990 Budget Enforcement Act to enforce its additional \$500 billion deficit reduction over 5 years, even though the 1993 package was not anticipated when the 1990 act was passed.

Rules are inherently impure. In the effort to set limits that inhibit undesirable actions, rules will sometimes inhibit desirable actions. This is unavoidable. However, this takes us one step further down into the quagmire of rule-making. *The very arbitrariness of rules means there must be an escape clause, perhaps allowing a*

supermajority vote in the Senate or a House Rules Committee decision to waive the rules from time to time. Thus, rules applied to legislation in general, rather than specific legislation like a budget agreement, are generally written to be waived in case of a national emergency. But this opens a major loophole, because it is so difficult to define an “emergency”.

### **Quantitative Targets and Technical Feasibility**

It must be technically possible to implement whatever rules are designed. That seems self evident, but the Congress is frequently drawn to proposals that are not practical. The Gramm-Rudman-Hollings law of 1985 (GRH) was of this type. It specified a declining path for the deficit that was to culminate in a balanced budget. If the deficit target was not achieved, spending was supposed to be cut or sequestered according to a complex formula.

The problem with any quantitative target for the budget balance is that the balance is usually affected much more in any year by the vagaries of the economy and technical factors than it is by legislation. That is to say, GRH forced the Congress to aim at a rapidly moving target. When the economy grew less vigorously than expected, the deficit shot up and the sequester necessary to achieve the target was so politically painful as to be unthinkable. Moreover, GRH was pro-cyclical, with deficit-cutting heaviest in recession and lightest when the economy was expanding rapidly. The original GRH deficit targets were adjusted upward in 1987, and then, abandoned altogether in 1990.

The experience with GRH has not prevented the Congress from contemplating similar quantitative targets from time to time. In the brief period of unified budget

surpluses at the turn of the century, the Congress considered a “lock box” that would aim for a unified budget surplus that would equal or exceed the surplus in the Social Security trust funds – another numerical target not just for one year, but presumably over time. Similarly, an amendment to the constitution that would require budget balance has often been considered. One can see states and localities wrestle with such constitutional or legislated limits, frequently resorting to outrageous accounting gimmicks (e.g., changing interest assumptions on pension plans; securitizing future tobacco settlement revenues) to balance their budgets on paper when the economy is weaker than expected.

### **The Budget Enforcement Act of 1990**

The question of whether the BEA rules that applied throughout much of the 1990s should be re-applied today has frequently been debated since the BEA expired at the end of fiscal 2002. We believe that today’s conditions are very different from those of the 1990-97 period when the rules worked effectively. The brief history that follows suggests that a new BEA would not provide an adequate answer to today’s budgetary quagmire.

When it became apparent that GRH was not working, President George H. W. Bush began difficult, bipartisan negotiations with the Democratically-controlled Congress. The result was a significant deficit reduction package. The agreement included significant tax increases and, after an initial flurry of spending increases, severe spending constraints for future years. There was a legitimate fear that the painfully negotiated package would erode over time because the Congress would not have the discipline strictly to adhere to the agreement. The main intent of the BEA was to enforce the 1990

agreement by restricting the ability of the Congress to pass legislation that deviated from its goal of deficit reduction.

The Budget Enforcement Act of 1990 (BEA) was thus passed mainly to protect the tax increases and spending constraints contained in the original agreement. The rules embodied in the agreement, which were adapted and extended under President Clinton's 1993 budget agreement worked extremely well through 1997. The BEA had two major elements. First, caps were imposed on discretionary spending for a five-year period. Both budget authority and outlays were limited. The caps had the effect of reducing discretionary spending relative to GDP, which, all else equal, will reduce the deficit in the long run. The spending caps did not apply to entitlements. The modest deficit-reducing entitlement reforms enacted in 1990 and 1993 and the more important tax increases were protected by pay-as-you-go (PAYGO) rules.<sup>1</sup> PAYGO stated that any tax cut or entitlement increase had to be paid for with some other tax increase or entitlement cut. In other words, the Congress was not allowed to make any changes in the non-discretionary part of the budget - entitlements or tax laws - that would increase the deficit. If there were new laws, they had to be paid for in the budget year and on average for five years. Later, the time horizon was extended to ten-years. To the extent the rules were violated, a sequester was supposed to occur that automatically reduced spending according to a formula similar to that used in the original Gramm-Rudman law.

When President Clinton and the Democrats in Congress negotiated another deficit reduction package in 1993, BEA spending caps were slightly modified and extended. The rules were again reaffirmed in the budget agreement of 1997 between Clinton and the

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<sup>1</sup> The distinction between the tax changes and the expenditure changes is not entirely clean. Some tax provisions are extended periodically, almost like discretionary programs. These provisions were then caught up in pay-as-you-go rules that called for other tax increases to pay for their further extension.

Republican Congress. This was the first deficit reduction agreement of the 1990s that allowed tax cuts. It was the goal of BEA to prevent the tax cuts from being increased unless they were paid for. It ultimately failed to achieve this goal. BEA was allowed to expire at the end of fiscal 2002.

There are a number of reasons that the BEA was so successful prior to 1998. First, it was backed by a broad political consensus that it was important to get the deficit under control and that meant adhering to the agreements of 1990 and 1993. Second, it focused on controlling legislative actions, which are under the control of Congress. It did not attempt directly to control something that cannot be controlled precisely, namely the deficit. Third, the BEA did not, itself, impose much political pain. Its goal was to enforce painful agreements negotiated previously. Thus, PAYGO did not force further reductions in the deficit. It only prevented the deficit from being increased. When the spending caps threatened to become too painful, they were adjusted upward. Nevertheless, BEA imposed considerable restraint with discretionary non-defense spending growing only 1.2 percent per year in real terms between 1990 and 1997. The one major deficit increasing action in this period—the tax cut in 1997—was paid for up front by cuts in entitlements, mainly Medicare – a cut that eventually saved much more and therefore became more painful than originally anticipated.

The politics of deficit reduction is affected significantly by how the press and the public define “cuts”. In many entitlement programs spending grows faster than GDP over time. Any change to the program that reduces the rate of growth is labeled a “cut”, even though the program may still grow faster than GDP after the change and the real benefit per beneficiary is still being increased. Similarly, under constant law, the real

income tax burden rises faster than real incomes as people are pushed into higher tax brackets and the real value of special tax benefits often increases as well. However, these are not defined to be tax increases or tax cuts.

Discretionary spending is treated quite differently. The budget baseline assumes that discretionary spending will increase with the rate of inflation. Any increase below this level is labeled a “cut” whereas anything above an inflation adjustment is called an “increase” even though real spending per capita may decline. Thus, paring discretionary spending (e.g., from 2 percent real growth to 0 real growth) might involve even more real economic pain than paring entitlement growth (e.g., from 8 percent real growth to 6 percent real growth), but the latter would be assessed as imposing more “political” pain given the nature of budget rhetoric and measurement of pain relative to “current law.” The nature of budget rhetoric helped BEA to be more successful in curbing nondefense discretionary spending growth through 1997 than in curbing entitlement growth. Nondefense discretionary spending fell from 3.5 to 3.3 percent of the GDP between 1990 and 1997 while Social Security, Medicare, and Medicaid rose from 6.9 to 8.1 percent..<sup>2</sup>

When a surplus emerged by surprise in 1998, the restraint previously imposed by BEA began to disintegrate. At first, the Congress exploited the loophole that emergency spending was exempt from the spending caps. Between 1991 and 1998, Congress had used the emergency provision sparingly as emergency spending averaged only \$5 billion per year outside the amounts required for Desert Storm. In 1999, emergency spending soared to \$23 billion and then, in 2000, to \$36 billion as even the census was declared to be an emergency. For fiscal 2001, the Congress simply raised the caps to whatever they

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<sup>2</sup> Total mandatory spending fell relatively over the period largely because the cost of the S & L bailout disappeared. The 1997 budget agreement slowed Medicare dramatically after 1997, but that proved so painful that much of the decline was reversed subsequently.

wanted to spend and did not use the subterfuge of an emergency. PAYGO was not violated to the same extent, but it too frayed for fiscal 2000 and 2001. Laws violating the PAYGO limits decreed that the excess should be ignored and that no sequester should occur.

The fact that the BEA worked extremely well through 1997 and then fell apart illustrates the importance of rules being buttressed by a broad political consensus supporting the goals of the rules. Once the deficit was vanquished, the Congress saw no reason to abide by the rules, even though they were still technically in force.

### **Another BEA: Can the Past be Prologue?**

Deficits have now returned with a vengeance and because the BEA worked so well through 1997, a number of groups would like to reinvigorate it. Would it work in today's political environment? Even if politically acceptable, could it work as a matter of economics?

It must be emphasized that conditions today are very different from those extant in 1990. First and most important, there is no bipartisan budget deal to be enforced, no up-front tax and/or entitlement reform that would then be backed up by limits on future discretionary spending and a PAYGO for new tax/entitlement legislation. It is not even clear that there is the same consensus behind the goal of a balanced budget. From 1982 until about 1997, the Congress was obsessed by the deficit; over this time period, it passed numerous tax increases and engaged in significant spending constraint.

No such reaction has greeted the soaring deficits of recent years. Our two presidential candidates weakly bow in the direction of fiscal responsibility by promising

to halve the deficit in four (Kerry) or five (Bush) years, but they do not say what they will do after that nor how they will accomplish it in the shorter run.<sup>3</sup> Even if there were a consensus behind a balanced budget, it is impossible to imagine a bipartisan budget deal being consummated until some of the poison is removed from today's partisan atmosphere.

We also noted that PAYGO worked partly because the explicit deficit cuts in 1990 and 1993 were enacted up front. Politically, then, Congress only had to face headlines about cuts at the times of the budget agreements; the remaining "deficit reduction" was achieved through the constraints on discretionary spending while revenues continued growing. Put differently, the PAYGO part of the budget agreements essentially just prevented deficit increases in future legislation, with a baseline for discretionary spending that meant that it would decline relative to GDP and revenues, but not absolutely in real terms.

Now consider the situation in 2004. Because the significant tax cuts of 2001, 2002, and 2003 are all sunset by current law, the strict application of PAYGO today would imply a major deficit reduction through significant increases not just in tax dollars, but in average and marginal tax rates compared to today's levels. Not only is there no consensus in favor of this course, there is a strong consensus that the tax cuts enjoyed by the middle class should be continued. The proponents of restoring PAYGO argue that it will be easy to get a 60 vote majority in the Senate for continuing tax cuts for the middle class, and their main goal is to erect a barrier against continuing the tax cuts for the wealthiest Americans.

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<sup>3</sup> President Bush has submitted a budget that nominally would achieve the result, but only by excluding such costs as probable budget supplementals for Iraq.

Even that move—which doesn’t get us very far toward budget balance—may not be very easy. There is no consensus about the wisdom of the tax cuts at the top end of the income distribution. As a result, there will be much strategizing about their continuation. Reestablishing PAYGO might have the perverse effect of providing a bargaining tool for proponents of lower marginal tax rates at the top and of lower rates on capital gains and dividends. They may have enough votes to threaten middle class cuts and relief from the alternative minimum tax unless they get the additional cuts they want. They can blame the other side for intransigence if middle class tax relief expires. Regardless of how things turn out, it is important to emphasize how differently PAYGO would operate now compared to how it was applied in the 1990s. The proponents want to use a budget rule to impose a tax increase on higher income Americans. In the 1990s, such tax increases were not imposed by rule, but rather by up-front negotiated agreements. The PAYGO rule was then designed to enforce the agreement, not to impose a new policy.

Although the change in the environment creates important differences in how PAYGO might function, there is less reason to believe that spending caps would be problematic. However, it must again be emphasized that they will only work if they do not impose too much pain.

Although caps that do not impose draconian restraints may be workable, it is hard to imagine much bipartisan support for a BEA that attempts to constrain discretionary spending and entitlements, but has little effect on tax policy. President Bush proposed a version of BEA with such characteristics, but his Democratic opponents derided the proposal. The Democrats’ main interest may have been to discourage an extension of the

President's tax cuts for upper income groups, but there is another substantive problem with the asymmetry of the President's proposal. Special tax exclusions and deductions (tax expenditures) can be a substitute for expenditure programs. By not restraining such special tax provisions, the President's approach could add to the complexity and inefficiency of our already complex and inefficient tax laws. And it offers almost a complete waiver from real spending constraint. President Clinton's tax proposal to subsidize local school construction proves that there is almost no type of subsidy that can't be put in the tax code.

While we believe strongly that the budget deficit should be reduced and while we strongly suspect that some increase in tax burdens above today's levels will be necessary to achieve that goal, we are extremely dubious that some simple set of BEA-like rules are sufficient in current circumstances. The battle will have to be joined more substantively. There has to be some agreed-upon set of goals that the rules are meant to help enforce or attain. In theory, the outcome will be superior if the decision process is aimed directly at reforming expenditure and tax programs rather than at some residual deficit number encumbered by artificial rules. In effect, some set of rules is probably required, but their likeliness of being effective for awhile would be greatly enhanced if there was enough consensus to make some tough choices made up front.

In any case, much of the forgoing discussion may be beside the point. As this is written, the Senate and the House are in conference on the budget resolution for 2005 and they are locked in a vigorous dispute over the type of PAYGO that might be adopted. House negotiators are apparently willing to accept the type of PAYGO proposed by President Bush, that is, one that applies to entitlements, but not to taxes, except perhaps

for such a short period that it would not affect making the cuts for upper income groups permanent. The Senate wants a PAYGO applied to both sides of the budget, but it would only be a rule providing for a point of order if PAYGO was violated. It would not be given the force of law, as was BEA, and it would not be enforced with a sequester. Thus, the relatively strong position of the Senate is pretty weak relative to the original PAYGO. It is obvious that no BEA will be passed in the near future. Even the weak PAYGO contemplated in the Senate may prevent any conference agreement on a Congressional Budget Resolution for fiscal 2005. If we cannot even make the Budget and Impoundment Control Act of 1974 work effectively, there is some risk that the whole Congressional budget process is in jeopardy.

### **Controlling Entitlements**

As one looks at the long run, it is clear that budget problems are not going to be solved simply by constraining discretionary spending or raising taxes. In the 1990s, one could get away with that tactic, but, even then, only by ignoring the long run. Health costs are soaring even now, while rapid growth in the elderly population and per recipient retirement benefits, along with declines in revenue growth due to a potentially stagnant labor force, begin about 2008. If this labor market change occurs as projected (we have some hope that, with institutional reform, it may be countered), its impact on the economy is roughly equivalent to increasing the unemployment rate by about 4/10s of 1 percent every year for 20 years running!

Meanwhile, GAO and CBO budget projections imply that Social Security, Medicare, and Medicaid will absorb 6 to 9 percent more of the GDP in 2030 than they do

today. So far the Congress has shown little interest in reform and has recently greatly worsened the situation by adding an expensive new prescription drug program to Medicare.

Our own projections show that by 2011 sustaining current entitlement promises, along with constant levels of defense spending and interest costs as a percentage of GDP, will absorb all revenues if they, too, are sustained at their existing levels. Thus, the main source of pressure in the budget is on these other domestic programs, and that pressure cannot be relieved without some entitlement reform.

**The Mandate-A-Proposal Approach.** Can budget rules be promulgated that might push the Congress toward entitlement reform? One approach is to try to let certain signals force the President to make a legislative proposal.

- Example 1. An interesting example of such a rule is contained in the prescription drug bill. If the trustees of Medicare project that, in the fiscal year in which the report is made or in any of the succeeding six fiscal years, general revenues will be required to finance more than 45 percent of the total costs of all parts of Medicare, they must report this fact. If such a report is made in two consecutive years it is to be treated as a “Medicare funding warning”. The President must respond to this warning with a legislative proposal within 15 days of submitting a budget. If the House does not vote on the legislation by July 30, there is a procedure for discharging the legislation from the relevant committees and considering it in an expedited manner. Similar discharge procedures are used in the Senate and debate on the legislation is limited. The 2004 trustees report for Medicare suggests that general revenue funding will first pass 45 percent of total Medicare costs in 2012. Unless the outlook improves over the next year, a report will have to be issued in 2005 and a second report in 2006. This will trigger a “Medicare funding warning”. Although the procedure does not guarantee that the financial problems of Medicare will be cured, it will continually attract attention to the problem.
- Example 2: In Japan every five years the financial status of the system is reviewed, and the legislature is expected to take action to better the situation when the system is in trouble. Even though the rule has failed to force the Japanese to fully contend with the dire situation caused by their rapidly aging population, they have taken small actions over the years that have cumulated into a significant, if not sufficient, reform.

- Example 3: Senator Joseph Lieberman has put forward a proposal in the “Honest Government Accounting Act of 2003” that would require the President to submit a proposal when the net present value of all the government’s overall liabilities and commitments exceeds 1.25 percent of the discounted present value of all future earnings subject to payroll tax. (It would also establish a point of order against bills or amendments that adversely affects the net present value of government’s overall liabilities and commitments by more than 0.25% of the present discounted value of future earnings subject to payroll taxes.)

We doubt that proposals to require a proposal will provide a complete solution for the nation’s long-run budget problems (the attempt to craft tighter rules for points of order are more encouraging, but still do not get us out of the soup). There is no real enforcement mechanism if the President and the Congress choose not to act, and there are strong incentives for the President and the Congress to collude in avoiding short-run political pain. Still, the rules can draw attention to a serious long-run problem and put it on the national agenda. They may at least induce occasional incremental reforms that cumulate into something significant. And they may provide a vehicle for more dramatic reforms if a financial crisis threatens.

**The Automatic Adjustment Approach.** Much stronger measures need to be built into the law to provoke or sustain reform. For example, it might be stipulated that, absent other reform, or as a back-up to whatever reform is enacted, automatic adjustments would be made to bring particular entitlements into balance.

- Example 1: whenever the Social Security trustees assumptions showed a deficit for the trust funds in either the 75-year trust fund balance or the 50<sup>th</sup> to 75<sup>th</sup> years greater than one percent of payroll, the age of early and normal retirement would be re-indexed starting 5 years to reach whatever level was required to bring those two measures (both the 75-year and 50-75-year calculations) back into balance. (The increase in the retirement age in any one year might be limited, e.g., to two or three months.)

- Example 2: same as example 1, except that the adjustment would be conversion from wage indexing to the lower of price or wage indexing of bracket bend points in the Social Security benefit formula.
- Example 3: Notwithstanding any other Medicare changes made in a particular year, the rate of payment for all Medicare services would be price-adjusted every three months to keep total Medicare payments within a total budget cost prescribed by Congress.
- Example 4: There is today an automatic trigger for Medicare Part B premiums that keeps premium revenue at 25 percent of costs. This has worked quite well so far. One might also think of adding automatic increases in deductibles and co-payments. (The former has less effect on the size of the program and more on who pays for the program; the latter takes more health care financing outside the program.)

Note that in all these cases, Congress has the opportunity to adjust the law both before and after the automatic provision is put into action.

Liberals might complain that some of the triggers noted above affect benefits and not taxes, much as they complain about the asymmetry in the President's proposed PAYGO rule. However, there is a clear distinction. We did not suggest adjustments to entitlements, such as Food Stamps, that are not growing faster than the economy. We imposed restraints only on programs that are growing much faster than the economy and thus creating major budget problems. The Congress could act to raise taxes instead or otherwise modify the policy when the trigger was about to be pulled. Of course, a combination of both automatic tax increases and reductions in benefit growth could be built into the rule.

A major compromise—one that would tackle much of the current budgetary mess—would be to have these types of automatic rules apply to health and retirement programs, and a more complete PAYGO rule apply to tax cuts, including those that

would extend current law. The net result would be a budget that moved back into surplus for future years, allowing decisions over time by future voters and Congresses as to whether it was best to increase entitlement benefits such as retirement and health, reduce levels of taxes, or sustain the other domestic programs now scheduled for rapid decline.

Automatic rules are meant to force periodic debate. The ones noted here mainly limit pre-spending (through entitlements or tax cuts) future increases in revenues before they arrive. Such automatic rules are not intended to represent some final policy solution. Given the Congressional reluctance to take on politically difficult issues until crisis arises, however, these rules should be written in a way that brings about a reasonable, if not ideal, policy result that makes sense during the time when Congress does fail to act. The potential for significant lags before systematic structural reforms are undertaken suggests also that automatic rules are best when program specific, as in the examples above, rather than across-the-board (e.g., sequestration) to all programs.

Of course, any rule by its nature has a mindless component. In an ideal world, we would proceed with more fundamental reform. Rules, specifying automatic cuts are mainly proposed because the world is not ideal.

Some rules are less mindless than others. For example, indexing the retirement age for life expectancy is a reasonable way to insure that expenditures for old age are concentrated in old age. Wage and price indexing in many current laws are examples of automatic rules (although these actually tend to raise costs) that adjust program parameters in a fairly reasonable way over time (e.g., to tax real, but not inflationary, income). They have the beneficial practical effect that they save the Congress much time each year that might otherwise be spent debating the best way to adjust for factors like

inflation. But these examples may be among the more sanguine. In absence of any fundamental reform—and right now there is no sign of major reform occurring—automatic mechanisms need to be designed well. The hope is that their very presence will provoke more fundamental efforts both to improve programs structurally, as well as to ameliorate any capricious result that may result from the arbitrariness of the automatic mechanisms themselves.

### **Other Issues**

A number of rules attempt to protect the budget in the long run from legislators with very high discount rates. Slightly different rules in the Senate and House seek to create procedural barriers against increasing the generosity of Social Security without paying for it over a 75-year period. The Byrd rule in the Senate limits the content of reconciliation legislation.

Reconciliation procedures were originally conceived in the Budget Act of 1974 to make it easier to raise taxes or cut entitlements in order to achieve the deficit target contained in a budget resolution. Debate was to be limited in the Senate and only 51 votes were needed to pass a reconciliation bill. President Reagan and his budget director David Stockman cleverly transformed reconciliation into a vehicle that made it easier to enact tax *cuts*. In response Senator Byrd devised a rule that outlaws putting provisions into reconciliation legislation that increase the deficit beyond the time horizon used by the budget resolution.

The Byrd rule has so far prevented the tax cuts of 2001 and 2003 from being made permanent. The proponents of permanency would have had to muster 60 votes to overcome a point of order and this has so far proved impossible. As a result of the Byrd

rule, one can imagine a series of reconciliation bills passed by 51 votes in the Senate providing for temporary extensions of the tax cuts if there is no PAYGO rule. The effect on the budget in the longer run is similar to that of a permanent tax cut, but considerable uncertainty is introduced into the tax system. On the other hand, the Byrd rule gives future Congresses the opportunity to let the sunset take effect, which is probably easier than raising taxes after a permanent tax cut.

It is extremely difficult to design rules that prevent the Congress from imposing costs on future generations. It was noted previously that we have had a PAYGO rule that makes it procedurally difficult to add to the Social Security deficit over a 75-year time horizon. The rule has not been really been tested. The procedural hurdles that it creates are relatively easy to jump over. No sequester would be imposed if the rule is violated. Presumably, a similar rule could be imposed on Part A Medicare, but it would not have prohibited the passage of the prescription drug plan. That plan had enough bipartisan support to be overcome any restraining rules. Luckily, its cost was constrained somewhat by the Budget Resolution's limit of \$400 billion over ten years, but costs will soar after that.

As noted previously, the new Medicare bill does, however, contain a cost limiting rule for the long run that forces Presidential and Congressional action if more than 45 percent general revenue financing is required to cover total costs. We do not yet know how effective this rule will be, but if it helps, analogous rules could be created for any new entitlements.

Tax cuts are more difficult to deal with. The Bush tax cuts accidentally coincided with a drastic and surprising drop in revenues relative to income that was not caused by

the legislated cuts. Deficits would be minor today were it not for that surprising drop in revenues. One might think of a rule that sunset some portion of a legislated tax cut if revenues fell below some x percent of GDP. The problem is that could be pro-cyclical. Gramm-Rudman did provide that its rules could be suspended if CBO forecast a recession or stated that we were in one, and perhaps that should be considered.

But it must also be remembered that any rule made by the Congress can be suspended by the Congress. If there is a good substantive reason for suspending a rule, that should ideally be determined in a vigorous transparent debate. Unfortunately, the press did not pay much attention when the rules of the BEA were suspended opaquely in the late 1990s.

Some would like to promulgate rules that would prohibit the crass violation of the Byrd rule when the tax cuts of 2001 and 2003 were sunset artificially. The problem is that there are legitimate sunsets and illegitimate sunsets. It is difficult to use rules to differentiate one from the other. We think it more promising to devise rules that have a chance of restraining entitlement growth or tax cuts if some quantitative barrier is breached.

In conclusion, it must again be emphasized that the Congress is a 500-pound gorilla that can do whatever it wants. Rules can ultimately be enforced only by public opinion and that requires that they reflect national goals that are broadly supported. It also requires that the rules be simple enough that the public can easily see when they are being violated. Consequently, the creation of effective rules is no easy task. That fact makes us quite humble about the forgoing analysis. We do not mean to be dogmatic

about any of our suggestions. Our intent is only to provoke debate and to further the discussion.

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