

Federal Budget Process Structural Reform

Testimony before the U.S. House of Representatives Committee on the Budget

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Mr. Chairman and Members of the Committee, I appreciate this opportunity to discuss with you the need for structural reforms in the federal budget process. For the past decade, Congress and the executive branch have been operating under a complex and confusing amalgam of procedures established by the Congressional Budget and Impoundment Control Act of 1974 (CBA), the Balanced Budget and Emergency Control Act of 1985 (Gramm-Rudman-Hollings or GRH), and the Budget Enforcement Act of 1990 (BEA). While these procedures have helped transform the large and seemingly intractable budget deficits of the past into significant surpluses, they have been abused, misused, ignored and circumvented in recent years.

With the budget outlook better than it has been in generations and various provisions of the current process set to expire at the end of fiscal 2002, now is an appropriate time to review the efficacy of the current procedures. Should the expiring provisions be allowed to lapse, extended in their current form, or renewed in some revised configuration? Alternatively, would some entirely new procedural approach better serve the nation's interests in the new budget environment?

In an effort to help Congress address these questions, my statement

- describes a few of the major dimensions of an effective budget process,
- discusses some limits on what we should expect the budget process to accomplish, and
- lays out a new framework that, I believe, would better serve the needs of the nation in the future.

Characteristics of an effective budget process

A well functioning budget process provides a framework for making decisions about the appropriate levels and allocations of scarce government resources, the ways in which those resources are raised, and the degree to which fiscal policy stimulates or restrains the economy. It should establish the order in which various participants act; set out the limits of their actions; provide mechanisms to enforce decisions once they have been made; and spell out clearly the circumstances under which the process can be waived.

In democracies like that of the United States where the executive and legislative branches are elected independently, the budget process must command widespread support if it is to be effective. When it doesn't, one party, legislative chamber or branch of government can and will easily circumvent, paralyze, or game the process. This occurs because few outside the Beltway understand or care much about the process and so rarely do those who flout procedures pay a significant political price. Recently, we have experienced the consequences of an erosion in support for the budget process.

An effective budget process must also be aligned with the nation's fiscal policy goals. The objective which our current procedures were designed to achieve—a balanced budget—has been realized and, as a result, the process recently has become somewhat disconnected from reality. The difficulty lawmakers have had adhering to the discretionary spending caps established by the BEA illustrates the problems that can arise when a disconnect develops between the goals the process is designed to pursue and the fiscal reality.

An effective budget process should also encourage transparency and honesty. Dollars, the metric of budgets, are malleable and elusive. Revenues, program costs and savings can be hidden or exposed, minimized or exaggerated, delayed or accelerated. As much as possible, the budget process should make it difficult to distort reality in these ways.

Given the diverse scope of government activity, it is inevitable that dollars will be used to measure actions that have quite different fiscal consequences. A budget process must try to create a conversion system that strives for fiscal equivalency. Yet such a system cannot be so divorced from the numbers used in day to day discussion that it becomes incomprehensible to all but the budget experts. The credit reform system adopted as part of the BEA represented a significant accomplishment of this sort.

While budgeting is an annual process, the consequences of one year's budget decisions invariably extend far into the future. For this reason, an effective budget process must reveal, in as objective a fashion as possible, the most likely long-run fiscal impacts of current decisions. The process surrounding consideration of the Economic Growth and Tax Relief Reconciliation Act of 2001 was an egregious example of failure to follow this tenet.

Because the environment in which budget decisions are made is fluid and unpredictable, flexibility is an essential characteristic of any sustainable budget process. The economic outlook can change abruptly. Elections, natural disasters, the weather, and international crises can suddenly cause significant shifts in national priorities. An effective budget process must be able to adapt to the unexpected while at the same time not appearing too malleable or capricious. But even an appropriately flexible budget process should be reviewed critically at least once a decade. While a flexible process may be able to evolve through incremental modifications to accommodate changing circumstances and new priorities, there may be some completely different approach that would better serve the nation's interests.

These and other characteristics of an effective budget process often are in conflict. Tradeoffs inevitably must be made. Simplicity and transparency sometimes must be sacrificed to obtain a greater degree of fiscal equivalency or equity. Flexibility can undermine discipline. And the desire for full discussion of the issues can conflict with the need for timeliness.

The limits of an effective budget process

Budget procedures are not laws of nature or constitutional strictures. They are the rules and conventions by which lawmakers agree to play when they consider the budget. They are the road markers and speed limits on the fiscal highway. As such, they will be violated when the benefits of doing so exceed the costs and when no one is paying much attention—in other words, when budget issues are not in the center of the political debate.

Because budget procedures are intended to guide the behavior of elected officials, it is important that they be compatible with the political pressures and constraints lawmakers face. No process can ask lawmakers to make decisions that will cost them their jobs. The budget process must also fit within, not attempt to change, the larger institutional structures within which lawmakers work.

Because lawmakers have a very imperfect ability to control budget outcomes—spending, revenues, and the budget balance—the budget process should not hold them strictly accountable for budget outcomes. This was one fundamental flaw in the Gramm-Rudman-Hollings procedures which imposed sequestration if specific deficit targets could not be achieved even if the failure was the result of a weather-induced surge in farm price supports or a revenue shortfall associated with a slowing economy, developments over which elected officials have no control.

No budget process can force agreement. At best, procedures can facilitate and create an environment conducive to agreement and provide some political protection for those who must make the difficult decisions.

Towards a new budget process

Congress must consider whether to tune up and extend the existing budget process or turn to some new approach for the future. I recommend that you develop a new approach, one which is specifically designed for today's improved fiscal environment rather than the era of persistent deficits.

No matter which course is taken, the first challenge must be to agree on the fiscal goal for the procedures that will guide future budgeting. When the Congressional Budget Act was enacted, there was, at most, a very weak consensus that the budget should be balanced over the business cycle. Reflecting this ambiguity, the new process was structured to be neutral with respect to the fiscal outcome. It did not favor a balanced budget or any other fiscal result. Instead the objective of the process was to ensure that Congress both could evaluate the consequences of different fiscal outcomes and had the tools it needed to fashion a budget, independently of the executive branch, that would produce the fiscal result it wanted.

In the 1980s when a bipartisan consensus developed that large and persistent deficits were a serious national problem, balancing the unified budget became the explicit objective of the budget process. The Gramm-Rudman-Hollings procedures launched a frontal, but unsuccessful, assault on the deficit by requiring annual decrements in the deficit until a balanced budget was attained in fiscal 2001. The Budget Enforcement Act's approach was more subtle. It placed procedural hurdles in the path of those who would renege on the spending cuts and tax increases that were embodied in the multi-year deficit reduction packages that Congress and the President agreed to in 1990, 1993, and 1997. Nevertheless, the underlying objective of the BEA procedures was to achieve balance in the unified budget.

When the unified budget first registered a surplus in fiscal 1998, the goal of the process was no longer aligned with the reality of the budget. Because the budget had gone from deficit to surplus so quickly and unexpectedly, there was no time for a consensus to develop around a new fiscal objective. Frozen by a sense of disbelief over the nation's rapidly improving fiscal fortunes, paralyzed by partisan disagreements over priorities and constrained by the BEA's procedures, legislation that could have dissipated the emerging unified budget surplus was not enacted and an even more unexpected situation developed—surpluses appeared in the government's on-budget accounts starting in fiscal 1999.

Looking ahead, Congress must now decide whether the budget process should have an underlying fiscal objective and, if so, what that goal should be. One option is to return to that of the pre 1985 process which was neutral with respect to fiscal outcomes. That process, which was formulated at a time when public debt

amounted to only 24 percent of GDP and there was not full understanding of the burden that the baby boom generation would impose on the retirement programs, would probably not command much support today. Many would fear that the competition for votes in the current political environment, in which neither party has a firm or assured majority in either chamber, would lead to an era of fiscal profligacy if there were no clearly articulated fiscal goal.

Another option is to reaffirm the goal underlying the current process which is to attain and maintain balance in the unified budget. This goal would accommodate the many priorities that the President and Members have advocated over the last six months including increased spending for defense, education, agriculture and Medicare prescription drugs; further reductions in taxes; and added resources to seed private accounts in a reformed Social Security system. A third option, one that has garnered the most support at the rhetorical level, is to establish as the goal of the process maintaining a fiscal balance in the government's operating budget while saving the annual surpluses generated by the retirement programs for which the federal government faces unfunded future liabilities. At a minimum, this involves using the Social Security surplus to pay down public debt; at the maximum, it involves using the surpluses in the Medicare Hospital Insurance (HI), military retirement, and civil service retirement programs to retire public debt.

To the extent that there exists a consensus in Congress about the appropriate fiscal objective, it appears to include devoting both the Social Security and HI surpluses to debt reduction while attaining at least a balance in the government's other accounts. By overwhelming bipartisan majorities, the House of Representatives endorsed this position in each of the last three years (H.R. 1259, May 26, 1999; H.R. 3859, June 20, 2000; H.R. 2, February 13, 2001). And some support for the Fiscal 2002 Budget Resolution was conditional on assurances from the managers in both the House and the Senate that the resolution did not violate this fiscal goal. The Bush Administration, however, has explicitly rejected this fiscal goal but has conditionally endorsed the goal of saving the Social Security surplus and maintaining a balance in the government's non-Social Security accounts.

No matter what particular fiscal objective is adopted, any new or revised budget procedures should establish rules to govern actions when the fiscal objective has been exceeded or is projected to be exceeded in the future. This represents a new challenge. Few of the architects of the GRH and BEA legislation ever expected to live in an era of comfortable unified budget surpluses. However, that has been the reality for the past four years. And the January 2001 CBO projections clearly show that, under baseline assumptions, a long period lies ahead during which any of the fiscal policy objectives I have discussed would be exceeded. While the tax cut and the other promises made in the budget resolution and the weakening economy have changed the short run outlook, it is highly likely that policymakers will find that future budget projections show considerable fiscal flexibility five to ten years out.

Considering this possibility, any reform of the budget process should address the question: When and how should amounts in excess of the fiscal goal be dissipated? There are two strong arguments for establishing procedures that sharply limit lawmakers' abilities to dissipate *projected* excess amounts. The first is the inherent uncertainty of budget projections, particularly projections that depict conditions more than two or three years in the future. If lawmakers enact tax cuts and spending increases now that absorb all of the excess amounts projected for the future, later on if the economy does not perform as expected or if entitlement programs grow more rapidly than projected they could be forced to choose between approving painful tax increases or spending cuts or falling short of their fiscal goal. The second is an issue of equity. Even if budget projections were perfectly accurate, future Congresses should be given some say over the fiscal leeway that is projected to emerge on their watch. The priorities today's lawmakers see for the future will almost certainly not turn out to be the priorities of lawmakers and the public five or ten years from now. Economic, social, and international conditions will be different in ways that we cannot predict today.

For these reasons, it makes sense for the budget process to limit the extent to which lawmakers can commit, through legislative action, resources that are projected to be in excess of the fiscal goal in the future. I have outlined elsewhere a budget process reform which would allow each new Congress to encumber only a declining fraction of the resources that exceed the fiscal goal under the baseline projection. No more than 80 percent of the excess resources predicted for the first two years would be available for commitment. For the next two year period the allowance would drop to 70 percent, for the subsequent period to 60 percent, and so on until the 9th and 10th years of the projection period for which the new Congress would only be able to encumber 40 percent of the resources that were projected to exceed the fiscal goal. When each new Congress convened, the Congress would calculate a new allowance using CBO estimates.

This system would be enforced through variants of the pay-as-you-go and discretionary cap systems that are parts of the current process. To determine whether future allowances were likely to be breached, all discretionary spending would be projected forward using the baseline projection methods. The future costs of newly enacted entitlement and tax legislation would be projected under the assumptions that all provisions were fully implemented by the seventh year and that no provisions expired or were cut back in the out years. These safeguards would ward off some of the gimmicks that have been used recently to minimize the apparent budget impacts of program expansions and tax cuts.

Conclusion

While many elements of the CBA, GRH, and BEA processes should be retained and, in fact, should form the core of the new budget process, more in the way of fundamental reform is also needed. It will not be enough to make some incremental changes in the discretionary spending caps, the pay-as-you-go system and the rules governing sequestration. Since our current processes were formulated, the budget environment has changed significantly in ways that no one could have predicted. A new set of procedures, one that reflects the

new reality, is needed. While it may be too late to consider such reforms this year, time is short. Confidence in budget procedures has eroded markedly over the past three years. Too often decision makers at both ends of Pennsylvania Avenue have viewed the process as an elaborate game through which to gain short run political advantage rather than a set of consensual restraints designed to further the common good and preserve some modicum of fiscal flexibility for the future.

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