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The Senate Budget Reform Package – A Good Start in Need of Balance

You have heard us say it before and we will say it again: Budget rules alone cannot do the heavy lifting required to address the nation's fiscal challenges. One could argue that focusing on budget reform is a diversion from the issues that should be getting Members' attention—the revenue and spending policy changes to bring the short- and long-term budget back into balance. But given the polarized partisan environment and that it is an election year, improvements to budget process may be the most one can hope for. While bad rules contribute to bad outcomes, and rules that are routinely ignored undermine respect for the budget process, good rules can indeed be helpful.

Consideration of the line-item veto championed by the White House has led to an expansion in the number of reforms that Congress is deliberating. The most comprehensive package is the "Stop Over-Spending Act of 2006," introduced by Senator Gregg, Chairman of the Budget Committee.

In this update we cover the recommendations in the Gregg proposal, the alternative proposal by Senator Conrad, and the Committee for a Responsible Federal Budget's existing reform recommendations.

Central provisions of the SOS Act include:

Deficit Reduction Targets. The Act creates deficit reduction targets, structured as a percentage of GDP. (The targets are 2.75% of GDP in 2007; 2.25% in 2008; 1.75% in 2009; 1.25% in 2010; 0.75% in 2011 and 0.5% in 2012 and beyond.) If the Office of Management and Budget estimates that the targets will not be met, Congress has to reduce mandatory spending to achieve the savings. If Congress fails to produce the savings, there is then an across-the-board reduction in mandatory spending. (Social Security, net interest, funds obligated by law, other obligations backed by the full faith and credit of the U.S. government, and existing legal contracts would be exempt.)

Many experts see the Graham-Rudman-Hollings deficit targets of the past as a failure since they were not met. On the other hand, they did successfully focus greater attention on the deficit and created pressure to act, which helped precipitate the 1990 budget agreement.

It is our opinion that we should have an explicit deficit reduction goal to which Congress is statutorily committed. Currently, we do not. The problem with deficit level targets is that they are a derivative of expenditure and revenue levels and minor changes in economic conditions and technical estimates can cause wide swings in the deficit. This provision of the Act could be improved by including ongoing adjustments to the targets that would reflect changes in deficit projections due to economic and technical factors. While a moving target could create confusion, it would more accurately reflect the economic climate in which Congress was operating. It would also be desirable to target spending and revenue levels to clarify which side of the budget was causing any deterioration in the deficit. Another option would be to have a target based on the debt-to-GDP ratio, which would be a less volatile target.

In terms of the levels, we believe the goals in the SOS Act should be more aggressive. They do not impose enough discipline in the early years and defer tough choices until the next decade. Congress would be allowed to increase the deficit above current projections in each of the next three years before requiring very modest deficit reduction in 2010 compared to the CBO current baseline.

Deficit Under Different Scenarios

	SOS Goals	CBO Baseline	Adjusted Baseline* (Assumes Tax Cuts are Extended)	President's Budget (Estimated in Mid- Session Review)
2007	2.75%	1.9%	2.7%	2.4%
2008	2.25%	1.7%	2.3%	1.3%
2009	1.75%	1.5%	1.9%	1.0%
2010	1.25%	1.3%	1.8%	0.8%
2011	0.75%	0.7%	1.8%	0.7%
2012	0.50%	-0.3%	1.5%	N/A

* Repeating supplementals are removed from the baseline and are replaced with the emergency spending limits in SOS bill.

We are also concerned about the Act's lack of balance. Automatic reductions would be applied on the spending side of the budget, no matter what accounted for the failure to meet the deficit targets. For instance, if Congress passed deficit-financed tax cuts causing the deficit to be larger than anticipated, and Congress failed to take action to offset the deficit deterioration, spending cuts would automatically be used to offset the tax cuts. Advocates of lower taxes or higher spending for defense or domestic appropriations would have no incentive to negotiate compromises as part of an overall budget plan as the failure to reach an agreement would not affect their priorities.

We applaud the inclusion of entitlement programs in the sequestration process given that this is the area of the budget that will put the most long-term pressure on the budget, but we believe budget rules work better when they apply to all parts of the budget and give everyone a stake in controlling the deficit.

Mandatory Spending Control. A point of order is created against new mandatory spending that is not offset if the Medicare program is projected to become insolvent (defined as 45 percent or more of Medicare's costs coming from general revenues for two consecutive years) within the next seven years. The mandatory spending increases could be offset by higher revenues.

This is a new definition of insolvency for the Medicare program. From a budgetary perspective, Medicare is the single most challenging program to deal with and focusing on controlling costs is useful and necessary. (Ultimately, controlling the costs of Medicare and Medicaid will require more comprehensive healthcare reform.) A solvency definition built around the percentage of general revenues consumed by Medicare would make more sense since it would focus on the economy's ability to support the program.

Spending Caps. Statutory spending caps are established for discretionary spending. (\$873 billion in 2007; \$896 billion in 2008; \$920 billion in 2009.) New caps for emergency spending would also be created to gradually bring emergency spending back to historical levels by 2009. (\$90 billion in 2007; \$50 billion in 2008; \$30 billion in 2009.) The caps would be enforced by an across-the-board sequester in discretionary spending.

We believe that the budget resolution should include enforceable nominal dollar limits. In the past, statutory limits have proven to be one of the most effective approaches to instilling discipline into the budget process. To be successful, limits must be set at a reasonable level. Given Congress's recent track record of failing to enforce its own stated limits, we worry that Congress will quickly look for ways to bypass these new caps. While we applaud tight controls as an important way to control spending, there is a trade-off between more aggressive limits that would better control spending, and looser ones that would be more likely to be enforced. As we saw in the 1990s, reasonable caps can be extremely effective; unreasonable ones are routinely ignored, contributing to the breakdown of the process. Whether these caps prove to be reasonable depends on Members' commitment to sticking to them.

We are gratified to see that the package includes an approach to controlling emergency supplemental spending, an area about which the Committee has been deeply concerned. (See *Congress Needs to Reform Supplementals* at www.crfb.org.)

Line-item Rescission. The President is allowed to request rescission of certain budget items and Congress would consider the request under an expedited process. This version of the line-item veto would limit the President to four rescission packages per year and would prevent items from appearing repeatedly in rescission packages. The Act also applies rescission authority to targeted tax benefits.

The Committee supports this provision and applauds that savings would go to deficit reduction. However, we believe it is unlikely to make a significant contribution to improving the fiscal picture.

Biennial Budgeting. The budget authorizing and appropriations cycles are switched from one to two year cycles.

The budget process does not leave nearly enough time for oversight. Congress spends a significant amount of energy trying to meet frequently missed deadlines and spends too much time during the annual appropriations process repeating work it did the previous year. The Committee supports biennial budgeting in the hopes that it would free up resources for more productive purposes such as program review, strategic planning, oversight, evaluation, and reform. That said, we are skeptical that the change would result in dramatic improvements and we worry about making such a change during a period where there is already so much abuse of the supplementals process and strongly urge that additional controls, such as “Rainy Day Funds” to limit supplemental spending be included.

Two New Commissions. The Act creates one “fast-track” commission on entitlement programs and another on the accountability and efficiency of government programs and agencies.

The Committee recognizes that in today’s politically charged environment, commissions are a useful way to take pressure off of the President and Congress to initiate the specific ideas to balance entitlement programs. While it is unquestionably preferable for the President and Members of Congress to come forward with their own specific ideas, given the paucity of politicians who have had the courage to do so in recent years, commissions can help get the ball rolling. Ideally, the President would call for a Budget Summit with Members from both parties directly confronting the challenges of deficit reduction and entitlement reform.

The mission of the Entitlements Commission would be improved by focusing less on solvency for entitlements programs—a definition that can lead to accounting-oriented solutions that do not do much for the economy or the budget—and more on other metrics such as cash flow and/or share of the economy. The definition of solvency for Medicare and Medicaid effectively prevents the Commission from considering revenue increases outside of the dedicated payroll tax for Medicare. Since fundamental tax reform and changes to the make-up and balance of dedicated taxes may be part of entitlement reform packages, this definition could be counter-productive. Furthermore, the Commission would be required to recommend changes to limit the growth of Medicaid to GDP and could not consider increased revenues to allow for some growth to accommodate higher medical inflation and the increased caseloads as more seniors rely on Medicaid for long-term care. While controlling costs is necessary, the controls must be realistic to be effective, and some room for limited expansion would make them more likely to be successful.

To bring balance to the Commission and facilitate buy-in, it is important that the minority party be strongly represented in the make-up of the Commission. Giving each side veto-power over the other’s picks could also lead to balanced and widely respected members on the panels.

While an Entitlements Commission may help get needed entitlement reforms underway, the Committee is less convinced that a Commission to terminate programs would prove particularly effective or have much fiscal impact.

Alternatives to the Stop Over-Spending Act have been proposed. The Democratic alternative in the Senate, sponsored by Senators Conrad and Feingold, also contains a number of promising ideas:

Pay-As-You-Go. The Democratic alternative would restore statutory PAYGO. If tax cuts and mandatory spending increases are not offset, a sequestration in mandatory spending would be triggered.

The Committee has strongly supported dual-sided PAYGO in the past and continues to believe that some form of PAYGO is a critical component of ensuring budget discipline. It is necessary to apply PAYGO to both sides of the budget otherwise, there will always be strong incentives to run spending programs through the tax code in order to avoid the requirement of offsetting the costs. Furthermore, the lack of balance in one-sided PAYGO prevents the widespread political buy-in that would help the mechanism to be effective.

PAYGO will not improve the fiscal imbalances we currently face—the worthy intent of many of the components of the SOS ACT—but it will help to prevent them from getting worse. Under the current version, there is no effective limit on direct spending that results from laws already on the books. It may therefore be useful to find ways to improve the technical workings of PAYGO by better equalizing how tax and spending programs are treated. It is worth pointing out that for those who would like to control the growth of government spending, offsetting tax cuts with spending reductions should be seen as a desirable policy, not a problematic one.

Reconciliation Reforms. This provision would alter reconciliation so that it could no longer be used to increase deficits.

Although the reconciliation procedures set forth in the Budget Act were never explicitly limited to deficit reduction, the Committee believes that the special procedural protections facilitating the passage of reconciliation legislation should be reserved for politically difficult legislation making tough choices for deficit reduction. Congress does not seem to have many problems enacting legislation increasing the deficit by reducing revenues or increasing spending, and the budget process shouldn't make it even easier to do so.

Budgeting for War. Going forward, projected costs of the war would have to be included in the regular budget.

This would put an end to the irresponsible process of budgeting for the war through supplementals, which has opened up the supplemental process to further abuse. The Committee believes this is a good idea. It would be necessary to develop mechanisms to ensure that once the war costs begin to decline, the money is not diverted to other discretionary spending items.

In 2000, working with a number of outside experts, The Committee for a Responsible Federal Budget developed a list of federal budget process reform recommendations it supports.¹ These include:

Joint Budget Resolution. Congress and the President should agree on fiscal policy goals, i.e., aggregate revenues, expenditures, surpluses or deficits, debt levels or debt reduction targets, etc., and incorporate those agreements in a Joint Budget Resolution.

Expenditure Limits. Joint Budget Resolutions should include enforceable nominal dollar limits for both discretionary and direct spending.

Pay-As-You-Go. PAYGO discipline should be maintained. Joint Budget Resolutions should include limits on projected surpluses available to offset new entitlement / revenue changes without PAYGO offsets.

Biennial Budgets, Appropriations, and Tax Cycles. Switching to a two year cycle should free up significant resources for other more productive purposes.

Automatic Continuing Resolution. An automatic continuing resolution at or below the level of caps contained in the most recently enacted Joint Budget Resolution should provide stop-gap funding in the event Congress and the President fail to reach agreement on some of all regular appropriations bills. Automatic continuing resolutions should be very restrictive. They could create compelling incentives for Congress and the President to agree on regular appropriations bills.

Rainy Day Funds. Joint Budget Resolutions should include reasonable reserves against emergencies and other unforeseeable contingencies. “Emergencies” should be carefully and narrowly defined. There should be strong rules to govern expenditure of such funds, limiting the number and frequency of very large so-called emergency appropriations.

The Budget Should Distinguish Clearly between Spending and Revenues. There should be strict limits on any receipts scored as negative outlays. Activities that have all the characteristics of spending programs should not be scored as tax expenditures. There is a difference between spending and taxes and budgetary presentations should make clear distinctions between the two.

Enhanced Rescission. Enhanced Rescission should be enacted to take the place of line item veto.

Budget Concepts Commission. It is time for another Budget Concepts Commission. A concepts commission is the best approach to resolve technical issues and to address new issues as they arise. A new concepts commission should meet at regularly scheduled intervals of not less than 10 years.

¹ These are consensus views of our Board of Directors but do not necessarily represent the views of all directors on all issues.

The Committee applauds both the Chairman and the Ranking Member of the Senate Budget Committee for their ideas. Senator Gregg should be commended for expanding the current budget process discussion to issues beyond just the line-item veto and for developing bold mechanisms that would require that tough choices be made. Senator Conrad's proposal brings much needed balance to the discussion of budget reform. (Though the House will not be debating such a wide array of budget reforms, Congressman Spratt should also be applauded for the ideas he has suggested, which are similar to the reforms in the Conrad proposal.) Without broad political buy-in, budget rules will not materially improve the fiscal picture. A more balanced package with regard to the treatment of spending and revenues would likely lead to better policy outcomes and is necessary to gain bipartisan support.

As good as any plan to reform the budget process might be—and there are many things in both packages to commend—improvements in budget process alone will not cure what ails the budget. It is problematic that Congress has failed to pass a budget resolution and as attention turns to the budget process reform we have to wonder to what extent this is merely a diversion. As long as Congress continues to pass legislation cutting taxes and increasing spending we will not be able to gain control of the burgeoning deficit problem. And if Congress continues to ignore the need to reform Social Security, Medicare, and Medicaid, the long-term budget picture will not improve. Focusing on rules rather than policy changes is putting the cart before the horse. In the past, rules have been more successful at enforcing budget agreements than bringing about improvements on their own.

In many ways these rules are a recognition that Congress continues to be unwilling to make the necessary hard choices: The line-item veto would shift some power from Congress to the President; commissions shift power away from elected officials to outside experts; and triggers rely on defaults to replace the proactive type of decision-making one would hope to see demonstrated by Congress.

But the political reality is what it is and it appears that Congress is nowhere near to doing the heavy lifting that is necessary to actually confront the multiple budget challenges. Strong budget enforcement measures that help force action and serve as a check against fiscally irresponsible actions may be the best available option for the moment.