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BEFORE THE HOUSE BUDGET COMMITTEE

BUDGET REFORM PROPOSALS FOR THE 111TH CONGRESS

SEPTEMBER 25, 2008

Good morning, Chairman Spratt, Congressman Ryan, and Members of the Committee. Thank you for the opportunity to testify—it is a privilege to appear before this Committee on this important topic of budget process reform.

I am the President of the Committee for a Responsible Federal Budget. Our Co-Chairmen are Bill Frenzel and Leon Panetta and the Board consists of many past Directors of the Office of Management and Budget, the Congressional Budget Office, and past Chairs of the Federal Reserve Board and the Budget Committees. Our focus is the federal budget and related process issues. I am also the Program Director for the Fiscal Policy Program at the New America Foundation, a non-partisan think tank here in DC.

As recent events have made clear, the budget is under tremendous strain. One of the most important roles of the federal budget is to be able to meet the needs of the country whenever they might emerge. One cannot always anticipate when these events will take place—but whether it is a terrorist attack, a natural disaster, or a Wall Street meltdown, you want the budget to be flexible enough to respond as policy makers determine it should. When we run large budget deficits year after year, your hands are tied. Whether the package that is currently being considered ultimately costs \$100 billion, \$500 billion, or a trillion, it will greatly effect the flexibility of the budget in coming years—a budget that is already overly strained. And because we have been living beyond our means in the past, the components of this package that are meant to help stabilize the economy, could well do the opposite if the macroeconomic effects of excessive borrowing negatively impact the wider economy.

One thought directly relating to this crisis is that any repayments to the government resulting from its taking an equity stake in financial companies, or structuring some of the bailout package as loans, should be used directly to pay down the debt.

Otherwise, incoming revenues in future years that are merely partially offsetting the borrowed funds for the package you are considering today, could make the government's deficit appear smaller, and be used for other spending priorities. It is important to remember that the full amount of the package—no matter what that amount turns out to be—will be financed by borrowed funds. Like the financial sector, the government's overly-leveraged position is extremely troubling, and we should take measures to control it.

I have many further thoughts on the package to deal with the economic crisis we currently face, but I will focus my thoughts here on the important issue at hand—budget process reform.

In thinking about the types of changes that are needed to improve the budget process, best to start with the question of where the budget process is failing. Unfortunately, the answer is a lengthy one. We are working with rules that are decades old and were created when the budget, economy, and policy challenges were dramatically quite different than they are today. The rules and concepts have been amended in an ad-hoc manner resulting in a highly complex process. There are a number of issues that hinder the budgeting process, including:

Accounting/transparency - Many ways in which we do federal budget accounting are confusing, misleading, and nontransparent. The decision when to use cash or accrual accounting is not always clear; costs that appear beyond budget windows are not displayed in basic budget documents; and a variety of items from tax expenditures, to offsetting receipts, to the government's purchase of assets, are accounted for in ways that often confuse rather than illuminate the government's financial position.

Process - The most basic process of crafting the budget is no longer functioning. The budget that the President submits to Congress is completely divorced from the rest of the process. The budget that is ultimately adopted by Congress is toothless and can easily be overridden and regularly is. A central piece of the annual budget process—the passing of appropriations bills—focuses on the smallest part of the budget and leaves mandatory spending on auto-pilot. Deadlines are missed with distressing regularity. And the entire process is time consuming and contentious, yet fails on some of the most critical aspects of budgeting – thoughtfully contemplating the optimal allocation of government resources, and employing sufficient oversight and evaluation of all the programs in the budget.

Baselines - We now are in the confusing situation where the two major presidential campaigns are working off of baselines that are different than those the Budget Committees or the Congressional Budget Office use. Having numerous baselines—

including “current law”, “current policy”, “realistic”, and others—floating around reflects a number of factors. Some policies are slated to expire while others are not, based on the method that was used to pass them. Revenues and spending are oftentimes treated differently in the baseline. And of course, there is the campaigns’ desire to make the task of trying to pay for their policies easier by using a favorable baseline—a desire I worry Congress may succumb to as well.

Oversight - The process of budgeting is not merely determining how to raise and spend money but also evaluating the effectiveness of how money has been spent in the past in order to inform future decisions. Our current budget process over-emphasizes deciding how to spend money at the expense of oversight. All programs in the federal budget should be analyzed in detail on a regular basis. This includes discretionary spending programs, mandatory spending programs, and it also includes tax expenditures—the hundreds of billions of dollars that are run through the tax code but bear a greater resemblance to spending policy than tax policy. Currently, this area of the budget receives the least oversight of all. If we don't take the time to evaluate the purpose of government programs, determine whether the purpose is the best use of limited federal dollars, evaluate the effectiveness of the program, and apply tools such as cost-benefit analysis, we will surely misdirect resources.

Compartmentalization - Many policy issues need to be viewed in a comprehensive manner. For instance, questions about what investments best fuel economic growth or how to reform entitlements, should not be examined piecemeal. However the compartmentalization of policy expertise, the political process, and the congressional committee structure makes thinking about these policies through an integrated approach extremely challenging. Worrying about congressional jurisdiction and looking at policies with a narrow lens makes thoughtfully updating our retirement, health, investment, and tax policies nearly impossible.

Long-term - The budget process emphasizes short-term over long-term interests. First, there is the basic political environment where politicians are unavoidably affected by the short-term election cycle. On top of that, the entire budgeting process emphasizes what will occur in the next fiscal year and to a lesser extent policy effects throughout the truncated budget window, while very little emphasis is given to the long-term effects of the budget policies we put into place today. It is true that policies can always be changed in the future, but realistically once a policy is in place, it becomes entrenched with its own constituencies and can be quite difficult to change. A more balanced approach would require that we more thoroughly evaluate the short and long term effects of the policies we put in place today.

This list is not meant to be exhaustive but instead, to add to the discussion about what is broken in the budget process and what needs to be fixed.

In the past, the Committee for a Responsible Federal Budget has supported a number of budget reform ideas such as expenditure limits, joint budget resolutions, dual sided pay-as-you-go rules, automatic continuing resolutions, strict definitions for emergencies,

rainy day funds, proper distinguishing between spending and revenues, and enhanced rescission. A detailed summary of these ideas is attached and the full report, *Federal Budget Process: Recommendations for Reform*, can be found at: <http://www.crfb.org/pdf/2000/RecommendationforReform.pdf>. We continue to support these ideas, but as we look forward to the problems that most plague the budget process, I think the list will have to be expanded significantly.

We commend Congressman Schuler and the other Members of Congress who have focused on this area of the budget and developed recommendations for reform. There are a number of practical ideas in Congressman Schuler's proposal that we think would improve the process including efforts to increase the transparency of and the consideration that goes into conference reports, increasing transparency of earmarks, and strengthening oversight. Ideas such as these emphasize the need to make the information readily available to lawmakers about the policies and costs of the very dense bills they need to evaluate.

I will touch on a number of other areas for your consideration.

Budget concepts - Federal budget concepts dictate how the government accounts for its spending and revenues within a complex budgeting system. There has not been a full-fledged reevaluation of budget concepts since 1967, when the government adopted most of the recommendations of the President's Commission on Budget Concepts. Many of these concepts need to be reevaluated in light of the fact that the budget has changed drastically over the past 40 years. How we treat tax expenditures, the purchase of assets, government insurance, GSEs, and public pension promises are all examples of issues that could be considered. It is time to once again convene a Budget Concept's Commission to update our accounting practices and to help improve the transparency of the budget.

Development of the budget - The process of developing the annual budget must incorporate the most important aspects of responsible budgeting. The timeline may need to be altered. Built-in evaluation measures should be part of the budget. Though perhaps not on an annual basis, this should take place for all aspects of the budget at regular intervals. Congress should be forced to evaluate the trade-offs of different policy choices. One way to force this evaluation is to require that all new spending be paid for. The exercise of determining how to fully fund the budget makes the costs of the policies more transparent. Ending the blank check mentality forces Congress to deal with tradeoffs between lower taxes and higher spending and to better prioritize between competing spending proposals.

Other changes would include reconsidering the baseline to end some of the automatic growth in certain programs that drives up baseline assumptions, and to remove some of the existing biases. Finally mandatory spending must be brought back into the budgeting process so that there are checks on cost growth and more oversight of the nation's largest programs.

Enforcement - We continue to support tried-and-true measures of discretionary spending caps and pay-as-you-go rules. We think stringent but realistic discretionary spending caps should be put in place and that pay-go should apply to changes in taxes as well as mandatory spending. We need to end the types of abuses that have plagued PAYGO in recent years such as timing gimmicks, as well as strengthening Congresses' resolve not to waive the rule whenever the going gets tough.

We also need to go further. Though we do not have an institutional position on when they should be used, many members of the Committee for a Responsible Federal Budget believe that we should increase the use of "triggers" in the budget. This technique puts a backstop into the budget so that when parts of the budget are breached and Congress fails to act, automatic changes are made to put the budget back on course.

We are in a worse fiscal position than we were in when PAYGO was first enacted. An important question is whether PAYGO could be strengthened so that it does not just keep things from getting worse, but rather is designed to encourage, and when necessary, force action to improve the fiscal situation. This could take many forms, but one I will propose is that when the deficit and/or unfunded liability numbers reach a certain point as a share of GDP, perhaps a "Super PAYGO" that would require new costs to both be offset and paired with some level of deficit or unfunded liability reduction, would kick in. I also support a long-term PAYGO that restricts the level of future promises we make so that it is somehow connected to what we pay in taxes today. So for instance, one might put in place a requirement that future projected spending as a share of GDP can not exceed more than three percentage points of what taxpayers pay in GDP today. There are many varieties of such a mechanism, but the point is to restrict how much Congress today directs future generations to fund.

Certainly no improvements to the budget process will be sufficient to fix the budget mess we are in. Ultimately this is a *policy* problem more than a process problem and we will have to fix our taxing and spending policies in order to deal with the tremendous imbalance as we face. For all the clever ideas we discuss today and others in the process arena, if you and your colleagues agree to a plan that raises revenues and/or cuts spending by enough to significantly close the fiscal gap—that would be a far more important accomplishment.

On this issue we would like to commend Congressman Paul Ryan for the impressive work he has done in developing his "Roadmap for America's Future" which lays out how he would reform the budget to conform with his principles. We do not necessarily endorse the particulars of the plan, nor do we believe that real progress can be made until all sides agree that everything has to be on the table (meaning that no particular policies can be marked "off limits", not the people have to be willing to embrace particular policies they oppose), but we do think the exercise of getting specific is a huge step forward and we are grateful for Congressman Ryan's efforts in this area.

However, it may turn out that the best way to ease Members of Congress who are resistant to participating in meaningful budget reform into the necessary exercise is to

start with process first. Certain areas such as budget concepts, have not become overly politicized and lend themselves to bipartisan efforts which will help lay solid foundation for future larger efforts. My belief is that we should work on developing ideas that would improve all aspects of the budget from concepts to enforcement to policy and see when there is a political opening to move on any of these crucial ideas.

The bottom line is that if politicians choose to spend more than they are willing to pay for, if we spend more time creating next year's budget than analyzing the effectiveness of last year's, and if we continue to kick the can down the road on entitlement reform, no amount of process improvements will fix the budget. Ultimately, the most important components of responsible budgeting are the people involved in the process and the decisions they make. No matter what rules we create, what hurdles we develop, or what restrictions we build-in, Congress can always bypass them if they are not consistent with the policy goals to which Congress is committed.

I would like to close by saying we at the Committee for Responsible Federal Budget deeply appreciate the work of the House Budget Committee. We are strong admirers of the work of Chairman Spratt, Congressman Ryan and this Committee as a whole. Much like running a group called the Committee for Responsible Federal Budget, where I regularly have to turn to my colleagues at my think tank and say, yes, but how are you going to pay for it? being the Committee that pushes for thoughtful budgeting is not always appreciated as it should be. So thank you for the work you do, thank you for having me here today, and I look forward to your questions.

Appendix 1

Committee for a Responsible Federal Budget Reform Proposals

The Committee for a Responsible Federal Budget, in collaboration with experts inside and outside of government, developed a list of budget process reform recommendations that we believe will be useful in improving the efficiency, transparency, accountability, and outcomes of the budgeting process. These recommendations include:

Joint Budget Resolution – Currently, legislators labor under multiple budgets and multiple baselines. This greatly confuses the budget process and makes competing choices and their related trade-offs more difficult to evaluate. Under a Joint Budget Resolution, Congress and the President would agree on the broad fiscal goals that would guide budget decisions in a given year. Bringing the President into budgetary negotiations earlier in the process would help avoid the showdowns that can occur at the end of the process if Congress and the President are working on different tracks with different priorities. Additionally, the switch to a Joint Budget Resolution would create a higher level of accountability and better define when limits have been breached; thereby making it more difficult to “bust the budget.”

Expenditure Limits – The budget resolution should include enforceable nominal dollar limits for both discretionary and direct spending. In the past, statutory limits have proven to be one of the most effective approaches to instilling discipline into the budget process. However, limits must be set at a reasonable level. As we saw in the 1990s, reasonable caps can be extremely effective; unreasonable ones are routinely ignored, contributing to the breakdown of the process. As direct spending continues to grow as a share of the budget, it is important to consider different ways to control this area of the budget.

Pay-As-You-Go – The PAYGO principle, which requires that revenue reductions and direct spending increases be offset so as not to increase the deficit, remains a crucial budgeting principle that should be reinstated in full force. PAYGO will not improve the fiscal imbalances we currently face, but it will prevent them from getting worse. The Committee believes that it is necessary to apply PAYGO to both sides of the budget—spending and taxes. 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. The prescription drug program would have had to have been paid for rather than debt financed and revenues lost from the tax cuts would have been offset, had real PAYGO been in place over the past few years. 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.

Biennial Budgeting – The budget process does not leave nearly enough time for oversight. Congress spends a significant amount of energy trying to meet specific deadlines—which are often missed—and spends too much time during the annual appropriations process repeating work it did the previous year. One potential improvement would be to move budgets, appropriations, and tax cycles to a two-year budget cycle. This would free up more time for program review, strategic planning,

oversight, evaluation, and reform. That said, there are legitimate concerns about two year budgeting regimes. It is quite likely that we would see a dramatic increase in the number of supplemental appropriations bills—something that is already problematic. We believe that strict restrictions should be developed to control supplemental spending. As is the case today, supplementals should only be used in the case of emergencies, not as a means to increase spending in general budget areas—the incentives for mischief could be larger with two-year cycles.

Automatic Continuing Resolution – All too often Congress fails to reach agreement on its regular appropriations bills. We recommend an automatic continuing resolution at or below the level of spending caps contained in Budget Resolution to be used as a stopgap funding measure. Automatic continuing resolutions should be restrictive to create an incentive for Congress and the President to agree on regular appropriations bills rather than falling back on the continuing resolution.

Strict Definitions for Emergencies – The need for changes to our use of supplementals is illustrated by the emergency supplemental that was just passed in the Senate. Emergency supplementals should not be used to pay for normal government operations. In the past few years, many defense-related activities that should have been financed through the normal appropriations process have been funded through emergency supplementals. More and more, non-defense related spending has also been creeping into these bills. As the Chairman of this Subcommittee has highlighted, one merely has to look through the recent supplemental for many egregious examples. “Emergencies” should be carefully and narrowly defined, and there must be strong rules governing related expenditures. Otherwise emergency funds will continue to be employed as a way to add additional spending not contained in the budget. As my Co-Chairman Bill Frenzel has pointed out, supplementals have become a money machine. Once it became accepted practice to use supplementals as a money machine for regular defense spending it was only a matter of time before advocates of domestic spending started to look to the money machine for their programs as well.

Rainy Day Funds – The impact that a disaster such as Katrina can have on the federal budget is a reminder that the government should be planning and budgeting for such emergencies. While we never know when and in what form the next natural disaster will occur, we know that they do occur with unfortunate regularity. The Committee strongly supports the use of “Rainy Day Funds.” Such funds would require that Congress set aside reserve funds reflecting average costs of past years’ disasters to prepare for unforeseen, disaster-related costs. As noted above, what constitutes an emergency would have to be carefully and narrowly defined. While in all likelihood the costs of Katrina would have exceeded the amount in a Rainy Day Fund, the presence of the fund would have left the federal government in a better starting fiscal position to cover these costs. Also, when emergency costs exceed the level in emergency funds, Congress should exercise greater restraint in the rest of the budget to help offset unanticipated costs.

Proper Distinguishing Between Spending and Revenues – We are currently unable to accurately measure the true size of government. We label spending programs as “tax

cuts,” tax receipts as “fees,” and revenues as “negative outlays.” This level of complexity greatly decreases the transparency of the budget and the slippery definitions make it virtually impossible to accurately describe the size of government relative to the economy. The true size of government is probably greatly understated. This would never be tolerated for a private company, nor should it be for the federal government. To improve this misleading approach to accounting, 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.

Enhanced Rescission – The Committee supports enhanced rescission. The President should be able to identify and suggest the elimination of wasteful or low-priority spending programs while Congress should be given the chance to weigh in before funds are withheld or canceled.