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A CLOSER LOOK AT THE PRESIDENT'S FY 2010 BUDGET PROCESS REFORM PROPOSALS



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COMMISSION ON BUDGET REFORM



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Significant emphasis on budget reform over the next few years is imperative given the current economic conditions, the tremendous amount of borrowing taking place to help stabilize the economy, and the large and growing promises for Social Security, Medicare and Medicaid benefits.

To modernize an outdated Congressional budget process in light of the daunting economic challenges facing the nation, the Peter G. Peterson Foundation, The Pew Charitable Trusts and the Committee for a Responsible Federal Budget have launched a landmark partnership to build bipartisan consensus for a core set of reforms. **The Peterson-Pew Commission on Budget Reform** will convene the nation's preeminent experts to make recommendations for how best to strengthen the budget process used by federal lawmakers.

The Committee for a Responsible Federal Budget's Board of Directors will serve as the directors of the Commission. A number of technical advisers also will be involved in the effort, and the Commission will work closely with Members of Congress and the White House.

The Commission will run from January 2009 to December 2010. It will issue an Interim Report, a Final Report, and a series of working papers over that time period.

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Committee for a Responsible Federal Budget

The Committee for a Responsible Federal Budget is a bipartisan, non-profit organization committed to educating the public about issues that have significant fiscal policy impact. The Board is made up of many of the past leaders of the Budget Committees, the Congressional Budget Office, the Office of Management and Budget, the Government Accountability Office, and the Federal Reserve Board. www.crfb.org.

The release of the president's Fiscal Year (FY) 2010 Budget (Budget) provides the first glimpse of the Obama administration's views on budget controls and how it will use those rules and procedures to set its priorities. The Budget proposes to improve transparency and accountability in the budget process, displays ten-year budget projections, and changes the budgetary treatment of several popular programs. It also includes a placeholder for unexpected spending for natural disasters, a plan to improve the administration of mandatory spending and tax programs, an expedited rescission process, and proposes to revise the budgetary treatment of highway spending and to make the Pell Grant program a mandatory spending program.

However, the most significant changes involve the calculation of the budget baseline and the reintroduction of a statutory pay-as-you-go (PAYGO) framework. While the commitment to a statutory PAYGO demonstrates the administration's willingness to offset its proposed new tax cuts and entitlement initiatives, the Budget undercuts the value of this potentially important change by exempting the extension of many existing initiatives from PAYGO requirements. The Budget also fails to include caps on discretionary spending.

Since the release of its budget, the administration has expanded its budget reform proposals by introducing specific PAYGO legislation and a specific plan to use fast-track procedures and a commission for Medicare reforms. This paper describes these reform proposals, how they would lead to a few much-needed improvements in the budget process, and where they fall short in establishing a fiscally responsible budget process.¹

Statutory Pay-as-You-Go (PAYGO)

The administration has proposed a statutory PAYGO requirement for any new mandatory spending or tax laws. Its commitment to reinstating a statutory PAYGO provision is an important first step in reestablishing fiscal responsibility. While both the House and the Senate have internal PAYGO rules, no statutory requirement has existed since 2002, when the previous statutory PAYGO provisions, originally enacted as part of the Budget Enforcement Act (BEA) of 1990, expired.

Congress and previous administrations have used PAYGO to control the growth of mandatory spending programs—whose spending levels are set by law and which do not require Congress to appropriate funds annually. Simply put, PAYGO requires that the cost of any new mandatory spending programs or tax provisions must be offset by either reductions in other mandatory spending or increased revenue. In addition, statutory PAYGO includes an enforcement tool, sequestration, which imposes automatic cuts in certain mandatory spending programs if Congress and the president fail to enact proposals with offsets for any spending increases or lost revenues as a result of new legislation.

The administration's proposal would re-create the PAYGO ledger, an accounting of the costs and savings of all mandatory spending and tax legislation enacted in any given budget year. Under this plan, the Office of Management and Budget (OMB) would calculate the net cost of all legislation subject to PAYGO. If, according to this calculation, the total cost of all newly enacted mandatory spending or tax legislation enacted after the PAYGO law takes effect, were not offset by other mandatory spending or tax provisions, sequestration, an automatic reduction in spending across a relatively small base of mandatory spending programs, would kick in to make up the difference.

Changes from Previous PAYGO Requirements

The administration's proposed requirement differs from previous and existing PAYGO requirements in its application, calculation, and duration (see figure 1). It represents

an improvement over the status quo, since the only current PAYGO requirements are found in the operating rules of the House and Senate, which can be easily waived by either house of Congress. The new proposal would set PAYGO in law, binding Congress and the administration to PAYGO.

Under the president's proposal, as with the BEA PAYGO requirements, PAYGO would be triggered at the end of each congressional session. At this point, OMB, having recorded the cost of each new piece of mandatory spending or tax legislation on the PAYGO ledger, would determine if sequestration were required to offset any net cost. In contrast, under existing PAYGO rules, there is no on-going ledger, although the Senate does maintain a single-session scorecard. Bills may not increase the deficit and if it does, any member of Congress can raise a procedural objection (point of order) to the consideration of the bill on the House or Senate floor.

The administration also changes how OMB records the cost of individual legislation on the PAYGO ledger and how it determines the level of offsets necessary to avoid sequestration. Under the BEA PAYGO provisions, OMB recorded the estimated fiscal year annual cost of each piece of legislation on the PAYGO ledger. Under the new proposal, OMB would instead record one-tenth of the legislation's estimated ten-year cost. This ten-year averaging makes this proposal similar to the House and Senate requirements that PAYGO legislation must be deficit-neutral over ten years, rather than year-by-year, as the previous PAYGO law did. However, does this ten-year averaging obscure the long-term fiscal consequences of pending legislation when a particular program's costs increase significantly in the ninth and tenth years? This out-year growth often indicates a long-term commitment to spending at the higher level—a commitment that could be obscured by ten-year averaging. The administration argues that by averaging the ten-year costs on its five-year window, PAYGO prevents this problem it pulls those out-year costs forward to the present, potentially triggering an immediate sequester. At the same time however, averaging can also allow illusory out-year savings to offset the early-year costs, reducing the immediate budget threat to zero if the savings were pulled forward under averaging.

Significantly, unlike the previous administration, the Obama administration would apply PAYGO not only to legislation that increases mandatory spending but also to legislation that reduces revenue. This application to both tax

and spending legislation greatly increases PAYGO's ability to discourage legislation that would increase the deficit. A significant portion (\$359 billion) of the increase in the deficit between September 2002 (when the BEA PAYGO provisions expired) and September 2008 can be attributed to legislative actions. Forty-five percent of that amount (approximately \$163 billion) was due to revenue legislation that would have required offsets if PAYGO had been in place.² However, even when the previous PAYGO statute was still binding, Congress and the president waived it in 2001 and 2002 to implement politically popular and costly legislation and then Congress waived its rules in 2007 and 2008 for the alternative minimum tax (AMT) adjustment.

Treating tax cuts and spending programs equally under PAYGO may also reduce the use of tax provisions, instead of programmatic spending, to accomplish policy objectives. If PAYGO applies only to spending, it encourages Congress and the president to use tax provisions to achieve their policy goals, instead of evaluating the best way to encourage the behavior or implement the policy.

PAYGO and the Calculation of the Baseline

The baseline is the benchmark against which mandatory spending and revenue legislation are assessed and is used to determine which proposed legislation must be offset under PAYGO. In general, OMB and the Congressional Budget Office (CBO) measure the budgetary effects of any new legislation against a "current law" baseline, which assumes that a law will remain in effect as currently written. For example, if a law sets an expiration date for tax cuts, the baseline assumes that revenues will increase after that date. In the case of expiring programs, the baseline assumes that those programs and their costs will end, unless the law specifically exempts that program from this assumption.

The administration shifts from a "current law" to a "current policy" baseline. A current-policy baseline assumes that some popular and politically sensitive programs will not be permitted to expire and that Congress and any president would extend those programs and provisions. Since the cost of enacted PAYGO legislation is compared to the baseline, any bill extending these programs and provisions would have a zero net cost and hence would not require offsets.

However, proponents argue that these policies will almost certainly be renewed and a realistic baseline should include them. They also argue that using a current policy baseline

Fig. 1. PAYGO under the Budget Enforcement Act (BEA), House and Senate Rules, and the Administration's Proposal

Aspect	BEA PAYGO	Administration	House/Senate
Form	Statutory	Statutory	House Rules/Senate Rules and the 2010 budget resolution.
Duration	Created in 1990 and then extended to legislation enacted through September 30, 2002.	Expires December 31, 2013, but sequestration can apply in FY 2014 and 2015.	No sunset for House unless it drops the rule in a new Congress; Senate: September 30, 2018.
Triggering event	End-of-session ledger of net cost of enacted PAYGO legislation.	Same	Bill-by-bill
Scorekeeping/estimates	OMB	OMB	CBO
Permissible offsets	Offsets must come before Congress adjourns.	Same	Offsets do not necessarily have to be in the same bill. ^a
Period over which measures must be offset	Offset year-by-year, but enforced annually (plus current year).	Offset over 10 years, but enforced annually (plus current year). Would record the average budgetary effect on the yearly ledger.	Offset over five- and 10-year periods (plus current year).
Enforcement	Sequestration of limited number of mandatory spending programs. Maximum sequestration to Medicare, 4 percent.	Sequestration of limited number of mandatory spending programs. Maximum sequestration to Medicare, 4 percent.	Point of order prohibits consideration of bill/ amendment that would violate PAYGO.
Exemptions from PAYGO	Does not apply to discretionary spending, emergencies or interest.	Same. Also excludes off-budget.	Similar with some differences between House and Senate.
Exemptions from sequestration	Most direct spending programs are exempt, including means-tested entitlements, federal retirement, Social Security, and veterans programs. Medicare is limited to a four percent cut.	Almost identical except for a few small programs.	N/A.

Sources: "Chapter 15: Budget Reform Proposals" in *Budget of the United States Government, Fiscal Year 2010, Analytical Perspectives*, May 2009, 215–20; House Rules Committee and Senate Rules Committee web sites; and the summary of the administration's proposal at www.whitehouse.gov/omb. See also the following Congressional Research Service reports: James V. Saturno, "Points of Order in the Congressional Budget Process," June 1, 2009; Robert Keith, "The House's 'Pay-As-You-Go' (PAYGO) Rule in the 110th Congress: A Brief Overview," RL 33850, January 31, 2007; Bill Heniff and Robert Keith "Pay-As-You-Go Rules in the Federal Budget Process," RS2006, March 5, 2001; and Robert Keith and Bill Heniff "PAYGO Rules for Budget Enforcement in the House and Senate," RL 32835, May 3, 2005.

^a Under House and Senate rules, several different bills could use the same offset but ultimately, only one bill, as it was submitted to the President, could use that offset. The Senate also has a single-session scorecard to record the overall tabulation of costs/savings. See Richard Kogan, "The New Pay-as-You-Go Rule in the House of Representatives," Center for Budget and Policy Priorities, January 12, 2007. See www.cbpp.org, "Statement by Senator Judd Gregg on PAY-GO" in *Congressional Record*, March 14, 2008; and letters to Representatives Paul Ryan (July 14, 2009) and Majority Leader Steny Hoyer (July 22, 2009) from the CBO Director, Douglas Elmendorf, on the 2009 PAYGO proposals.

(and not forcing Congress and the administration to find offsets for these programs immediately) will keep Congress and the president from waiving PAYGO immediately. And if Congress wants to waive PAYGO, it will do so as it did with the 2001 tax cuts and the last AMT fixes. They maintain that a current-policy baseline that is realistic and followed might produce stronger enforcement than a current-law baseline that will almost certainly be violated.

However, the fiscal impact of this shift should not be underestimated. The redefinition of the baseline will increase spending and cut taxes by over \$3.5 trillion between 2010 and 2019. The administration's proposal also includes a temporary rule that would exempt several costly but popular tax and spending policies from PAYGO requirements: the extension of the 2001 and 2003 tax cuts; the extension of the 2001 estate tax changes; the Medicare sustainable growth rate changes; and the extension of the AMT patch. If these exemptions were subject to PAYGO rules, they would require enormous offsets over a 10-year period (see figure 2). And in its revision of its estimates in the annual Mid-Session review, the Administration added three more provisions to the current-policy baseline at a cost of approximately \$180 billion: the earned income and child tax credits (extended in the 2009 stimulus package but first enacted as a part of the 2001 tax cut package) as well as certain Pell Grant adjustments.

The administration also changes how expiring mandatory programs are treated in the baseline. Under its proposed current-policy baseline, all mandatory programs, with or without expiration dates, with outlays of \$50 million or more, are assumed to continue. This differs from the CBO and OMB current practice, which assumes that only some expiring mandatory spending is included in the baseline. Between the 1990 BEA and the 1997 Balanced Budget Act (BBA), all expiring mandatory programs were included in the baseline, which meant that it was not necessary to identify offsets for the cost of extending the programs. In 1997, the law changed to allow the congressional budget committees, CBO, and OMB to determine which new mandatory programs would be included in the baseline.

Thus, extending these programs has a net cost of zero under current or previous PAYGO provisions. Any program that does not fall into the protected category requires an offset when it is extended. In response to the original version of the House PAYGO bill that mirrored the administration's proposal, CBO estimated that including all expiring programs in the baseline—eliminating the need for offsets—would add \$25 billion to the deficit over ten years. However, this baseline change would alleviate the problem raised by the legal challenge to the 1997 law which put the decisions on which programs should be exempted in the hands of the

Fig. 2. Budgetary Effects of PAYGO Exemptions (in billions of dollars)

Extending expiring provisions	FY 2010	FY 2010-2019
Expiring tax cuts	4.0	2,682.0
Physician payments	12.0	311.0
Alternative Minimum Tax	13.0	546.0
Other adjustments	-2.0	-12.0
<i>Total expiring provisions</i>	27.0	3,527.0

Source: "Table S-7. Bridge from Budget Enforcement Act Baseline to Baseline Projection of Current Policy", p. 15 in *Budget of the United States Government, Fiscal Year 2010, Updated Summary Tables*, and "Table S-7. Bridge from Budget Enforcement Act Baseline to Baseline Projection of Current Policy" in *Mid-Session Review, Budget of the United States Government, Fiscal Year 2010, August 2009*, p. 37; and "Table S-11. Mandatory and Receipt Proposals" in *Budget of the United States Government, Fiscal Year 2010, Updated Summary Tables, May 2009*, pp. 21-27; "Table S-8, Change in the Baseline Projection of Current Policy From May Budget", p. 38-39; and "Table S-11. Mandatory and Receipt Proposals" in *Mid-Session Review, Budget of the United States Government, Fiscal Year 2010, August 2009*, pp. 43-54.

budget committees, rather than putting the exemptions in a law enacted by Congress and the president.³

These re-definitions, together with the exemptions described elsewhere in this paper, undercut the administration's step forward on fiscal responsibility. The switch to a "current-policy" baseline allows the Administration to reap savings from some initiatives and not pay for others. For example, under a current-policy baseline, the administration's proposal to extend most of the 2001 and 2003 tax cuts will have no budgetary cost, while its decision to end certain tax cuts for higher-income taxpayers will generate a savings since those cuts are assumed to continue in the baseline.

Apart from these very large exemptions, the administration generally complies with PAYGO requirements for its new policy proposals. It closes the loophole that allows increases in mandatory programs to escape PAYGO requirements if the first-year cost is funded by the congressional appropriations committees in their annual appropriations bills. Currently, under this scenario, the committees are not responsible for the programs' costs in future years or permanent changes in mandatory programs, and the costs of such changes are never subject to PAYGO.

In its May estimate, the administration's mandatory spending and tax proposals would reduce the deficit by \$645.8 billion over 10 years (\$684.7 billion over 10 years in its Mid-Session Review). However, its averaging proposal allows the administration to spread the savings over 10 years. If the administration subjected its budget proposals to PAYGO in FY 2010 and did not average the cost, a sequestration of \$54.7 billion at the end of FY 2010 would be necessary (re-estimated at \$38.1 billion in Mid-Session Review).⁴

Limitations of PAYGO

The administration's PAYGO proposal shares certain limitations with its statutory predecessor. PAYGO does not apply to the growth in mandatory spending that will occur under existing law. Congress and the White House originally designed PAYGO to block the creation of new mandatory spending programs or additional revenue-cutting provisions without making cuts to existing spending programs or adding revenue-raising provisions. PAYGO is essentially a "make matters no worse" budget rule. In this regard, especially during its early years, PAYGO was relatively successful in forcing policymakers to confront

the cost of their new legislative proposals. However, this emphasis always ignored the largest source of entitlement growth—that which would occur under existing law.

Second, PAYGO overlooks the long-term cost implications of new mandatory spending programs or tax provisions. This focus on the short-term consequences (five or ten year windows) of legislation has led policymakers in the past to create budget gimmicks to mask the true cost of legislation, such as delaying a program's implementation to shift its costs just outside the budgetary window. Congress and the president can also waive statutory PAYGO, as they did in 2001 and 2002, or "clean-off" the PAYGO ledger, as happened in 2002.

Third, it excludes the single largest entitlement, Social Security, and protects most existing mandatory programs, including veterans' benefits, payments to retirement funds, many means-tested programs, and all refundable tax credits—approximately 95 percent of all mandatory spending outlays—from sequestration.⁵ Narrowing the base in this way results in a large *pro rata* reduction in the remaining programs for offsetting any costly initiatives, such as the Bush administration's Medicare prescription drug plan. Unfortunately, if policymakers assume they would never allow large cuts in these programs, PAYGO's ability to compel offsets for popular and costly legislation will be undermined. While the experience of the period between 1990-2002 indicates that the size of the base has no relevance to congressional adherence to PAYGO rules, using such a small base does keep Congress and the President from having to make trade-offs between competing national priorities.

Lastly, PAYGO does not apply to discretionary appropriations, which are a full third of federal spending. While the statutory version of PAYGO always applied solely to mandatory spending and revenue legislation, it was coupled with caps on discretionary spending when it was initially enacted in 1990 and extended in 1993 and 1997. Unfortunately, the president's proposal lacks a discretionary spending component. While the fiscal impact of PAYGO legislation is far more significant than the impact of discretionary spending because tax and entitlement laws are permanent or multi-year commitments and usually open-ended, a PAYGO rule without discretionary spending caps will not hold policymakers accountable for what remains the most common form of spending legislation. ❖

Fig. 3. Emergency Spending, Fiscal Years 1991-2009 (in millions of dollars)

Type of Emergency Spending	FY 1991-2009
Emergency Spending	1,560,918
Security Spending	956,683
Total, Non-Security Emergency Spending	604,235
Average	31,802
“True” Emergencies (as defined by OMB)	1,413,669
Security Spending	956,683
Total, Non-Security “True” Emergency Spending	456,986
Average	24,052

Source: OMB data. OMB analyzed emergency spending over this period and categorized certain spending as “true emergencies” by limiting the definition

to Desert Storm/Desert Shield funding, the response to 9/11, the homeland and border security bills, Iraq/Afghanistan costs, the pandemic

influenza response, and the response to Katrina.

‘Emergency’ Spending

The administration’s proposal for ‘emergency’ spending retains the basic framework used by Congress and previous administrations since at least 1990. The proposal does not define or place a limit on the overall level of emergency spending. More importantly, it continues the practice of designating individual spending or tax provisions as emergency spending solely to exempt the provisions from budgetary limits or rules.

However, it does include three major changes to this basic framework, including how the baseline treats emergency spending. It also introduces a placeholder for disaster spending and changes how the Budget reflects and presents the cost of the wars in Afghanistan and Iraq. The first two proposals change how the baseline records emergency spending. The Budget, following the example of the Bush administration’s budgets, discontinues the current CBO convention, based on BEA standards, which includes all discretionary spending, including emergency spending, in the baseline and then inflates all current-year spending into the future. The Budget does not include emergency spending in its baseline calculation of future-year discretionary

spending. The administration correctly argues that the baseline should not automatically include and inflate emergency spending because, by definition, emergency spending is for one-time nonrecurring events. The Budget estimates that these changes will result in a reduction to the baseline totals of \$8 billion in FY 2010 and \$225 billion over 10 years.

The baseline also includes a placeholder for future major disasters of \$8 billion in FY 2010 and \$220 billion over 10 years. Previous administrations have not included placeholders, arguing that disasters or emergencies are unpredictable and placeholders unnecessary because emergency spending is exempt from budget limits. However, placeholders have begun to gain favor, and some congressional budget resolutions have included a placeholder for emergency spending.

The Budget does not provide a detailed explanation for the \$220 billion figure, stating only that the number is based on the probability of major disasters. In comparison, between fiscal years 1991 and 2009, prior to the financial crisis, an average of \$32 billion was designated as emergency spending annually (see figure 3).

The administration's placeholder will not address other problems that have resulted from the use of the emergency spending designation. It is not a true disaster reserve fund because the administration is not actually requesting resources for the fund. Thus, the placeholder cannot control the level of emergency spending because it places no limits on any future spending request by the president but including a placeholder might have encouraged Congress to use the reserve fund for other purposes or cut the fund entirely to claim "savings". It cannot stop Congress from misusing the emergency designation to evade budgetary limits or for projects that are not true emergencies. The previous administration tried to make it more difficult to use the emergency designation to bypass spending controls by adopting a tougher definition of emergency spending. While the tougher definition was not binding, it gave the White House ammunition in negotiations with the appropriations committees against questionable emergency-designated spending. However, at a minimum, the administration's inclusion of a placeholder recognizes that the federal government always needs some resources for emergencies, even if a particular individual emergency cannot be anticipated.

However, in another positive step forward, the administration's budget makes the costs of the wars in Afghanistan and Iraq much more transparent. Its FY 2010 regular budget request for the Department of Defense (DOD) includes \$130 billion for the cost of the two wars. The Bush administration regularly excluded those costs from its regular budget submission, submitting annual emergency supplemental requests. This practice diminished the value of the president's discretionary budget request and precluded a fair comparison of the administration's overall domestic and defense priorities. Including war costs in the regular budget improves the transparency of the president's defense request and allows meaningful comparisons between the administration's domestic and defense priorities.

The Budget does not treat war-related costs and emergency-designated spending comparably. The BEA baseline includes the 2009 enacted levels for all discretionary programs, including the DOD levels. The administration argues that, since the 2009 levels for DOD do not reflect the full cost of the war in 2009, the BEA baseline underestimates the long-term costs of current policy. Thus, the Budget adjusts the baseline levels for DOD to reflect the administration's estimate of the true 2009 costs, including the funds already appropriated and the funds in the then-

outstanding supplemental appropriations bill. And since the full war costs are included in the baseline, the administration can count as savings any proposed reduction from these levels as it reduces the scale of overseas operations. ■

Expedited Rescission

The Budget proposes an expedited rescission process to encourage a congressional up-or-down vote on any rescission proposals for which the president requested expedited action. The House of Representatives would have to vote on any proposed rescission package within 15 days after it was submitted, with the Senate having another eight days to vote. Because the administration's proposal does not include sanctions on Congress if it does not vote, the proposal technically does not require congressional action.

While the president's proposal has some similarities with the Line Item Veto Act (LIVA), it has been crafted to avoid the problems that led to the act's invalidation by the Supreme Court. Under LIVA, if the president proposed a rescission, it took effect unless Congress objected. In contrast, under the current proposal, a rescission would not take effect until Congress passed the proposal and it became law.

Currently, under the Congressional Budget and Impoundment Control Act of 1974, the president can temporarily halt the spending on items he has proposed for rescission for 45 days while Congress considers the legislation.⁶ However, the act does not require Congress to vote on a president's proposed rescissions.

This expedited rescission proposal is similar to the expedited procedures used for trade agreements, base closures, provisions of the Line Item Veto Act (LIVA), and the Medicare solvency trigger, which were all intended to allow Congress to vote up or down on certain policies proposed or negotiated by the executive branch.

While the president's proposal has some similarities with LIVA, it has been crafted to avoid the problems that led to

the act's invalidation by the Supreme Court. Under LIVA, if the president proposed a rescission, it took effect unless Congress objected. In contrast, under the current proposal, a rescission would not take effect until Congress passed the proposal and it became law. Moreover, the proposal would only affect discretionary spending in annual appropriations bills. In contrast, LIVA also applied to mandatory spending increases and certain tax provisions.⁷

Both the president's proposal and existing rescission procedures are predicated on the assumption that members of Congress are unlikely to vote on the rescission of funding that benefits their states and districts without the political cover of a larger bill with multiple provisions. Policymakers are seldom confronted with an up-or-down vote on individual provisions. Virtually all appropriations are part of large multi-agency appropriations bills, which provide policymakers ample political cover. Members can justify voting for a bill funding another member's pet project by arguing that they were supporting other worthy provisions in the bill. If Congress had a deadline for voting on a rescission package, it would either have to show support for the spending in question by voting against the president's package or agree to rescind the spending. If Congress voted on cuts to line-item programs or earmarks without the cover of a larger bill, there might be less earmarked spending, or at least, more public accountability for the decision to block particular rescission proposals.

However, constitutional concerns could affect this proposal's success. Under the U.S. Constitution, Congress can revise its rules unilaterally and has bypassed many expedited review processes. The last Congress overrode expedited procedures for fast-track authority to approve trade agreements and respond to the Medicare solvency triggers. Unfortunately, Congress is unlikely to comply with a voting timeframe if the leadership of either house or the majority party feels that it is politically disadvantageous to vote. ■

Expedited Consideration of Medicare Savings

The administration and independent health policy experts agree that rising health care costs threaten the fiscal stability of the federal budget and argue that any health care reform package must address the growth of health care costs, especially in the Medicare program. Since Medicare reimbursements set the standard for other health care plans, the

administration has argued that controlling Medicare costs will influence the larger health care industry.

While the administration did not include a formal proposal in the Budget, it has become increasingly willing to consider a procedural change to try to make the difficult trade-offs in health care financing a little less politically dangerous for Congress. In early June, it publicly supported two potential ways to control costs: Sen. Jay Rockefeller's proposed legislation to increase the authority of the Medicare Payment Advisory Commission (MedPAC) by making it an independent agency with the authority to implement its own recommendations and a proposal for a process—similar to the Base Realignment and Closure (BRAC) Commission process—for carrying out MedPAC's recommendations.

On July 17, the White House offered its own proposal urging Speaker of the House Nancy Pelosi to support a new process for reviewing Medicare changes as part of overall health care reform by creating an Independent Medicare Advisory Council (IMAC), similar to the BRAC Commission. According to the White House, this “would represent a critical step forward in creating a health care system that rewards quality, restrains unnecessary costs, and provides better care to more Americans.”

Under the administration's proposal, IMAC would include technical experts and health care professionals, and would make recommendations on payment rates and other policy reforms. To ensure that IMAC would bend the cost curve down rather than up, it would be prohibited from making broad changes that would increase net Medicare expenditures.

As a part of the Medicare reforms included in the Balanced Budget Act of 1997, Congress created MedPAC to make recommendations for improving the Medicare program and, in particular, for setting Medicare payment rates to physicians and hospitals. MedPAC holds public hearings and annually issues two reports with recommendations. However, it does not have the authority to implement those recommendations. Moreover, Congress has sometimes been reluctant to act on them and routinely blocks the implementation of recommended lower Medicare reimbursement rates.

The BRAC approach has been more successful. As Congress began to consider the restructuring and closure

Fig. 4. Program Integrity Allocation Adjustments Requests (in millions of dollars)

Program Initiative/ Allocation Adjustment	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2010-14
SSA Program Integrity	485	722	837	1,020	1,225	4,289
HHS Health Care Fraud and Abuse Control Program	311	327	343	361	381	1,723
Unemployment Insurance Improper Payments	50	55	60	65	70	300
IRS Enforcement	890	1,115	1,357	1,724	2,105	7,191
Federal-State Partnership	175	--	--	--	--	175
Total, Allocation Adjustment Request	1,911	2,219	2,597	3,170	3,781	13,678

Source: "Table 3, Program Integrity Allocation Adjustment Requests" in *Budget of the United States Government, Fiscal Year 2010, A New Era of Responsibility*, February 2009, pp. 40–41.

of military bases, it recognized that members, fearful of the economic implications and the political backlash, would be reluctant to vote to close military bases in their home districts. In 1990, it set up (and later revised and extended) a process to ensure that closure decisions were as removed from politics as possible. Under this process, the Secretary of Defense submitted a list of proposed closures to Congress, the BRAC Commission, and the public for review. The commission, made up of former military officers and defense experts, developed its report based on strategic defense needs and cost implications, and recommended a final list of base closures. Once the commission presented its recommendations, Congress had to pass a joint resolution of disapproval of the entire package or the recommendations took effect.

This approach gave members of Congress the political protection (and courage) to vote to close bases in their own districts by allowing them to tell special interest groups and their constituents that they voted for an entire list of recommended base closures based on the nation's defense needs. Since the BRAC process was initiated, Congress tried only three times to overturn the commission's recommendations and each time failed to get sufficient votes.⁸

The success of the BRAC approach speaks well for the administration's IMAC proposal (and the Rockefeller proposal). These proposals could help reduce political pressures surrounding the difficult and controversial health care and

Medicare reforms ahead and could, in turn, lead to more ambitious and more rational cost-reducing policies. ■

Program Integrity Adjustments

Congress and the White House have occasionally agreed to special budgetary exemptions for additional discretionary spending to improve the administration of mandatory spending programs. They have argued that these improvements can result in fewer overpayments of mandatory benefits or increased tax compliance, and thus lead to savings or increased revenue for the government. Without access to additional funds, the appropriations committees have little incentive to devote discretionary resources to improving mandatory programs, which are under the jurisdiction of the authorizing committees. They also do not receive "credit" within their budget totals for these savings that they could then use for other discretionary programs. Thus, these exemptions continue even after the expiration of discretionary spending caps.

The Budget identifies \$1.9 billion in FY 2010 and \$13.7 billion over five years to improve the administration of mandatory spending and revenue programs (see figure 4). It proposes that these funds can only be used for these purposes and must be used for additional spending on administrative activities, rather than as a substitute source of funding.

The administration's proposal is not new. It includes the same adjustments as the Bush administration for the Social

Security Administration, Health and Human Services, and the Internal Revenue Service but with additional resources and an adjustment for a new federal-state partnership for means-tested programs. This administration, like the last, argues that increasing appropriations for administrative activities such as tax compliance and reducing overpayments will result in substantial savings.

However, the Obama budget goes a step further and includes the estimated fiscal savings—\$48.4 billion over 10 years—in its overall budget totals.⁹ The administration and Congress would have to change how these expected savings are scored to count them.¹⁰ A scorekeeping rule prevents Congress and the president from claiming potentially illusory savings in mandatory spending or revenue programs from increased program oversight activities and then using the savings to fund other mandatory spending. Although improved administration of entitlement programs could result in better government and in long-term savings or increased revenue, the Government Accountability Office (GAO), OMB, and CBO should review these activities to ensure that the promised savings are realized. ■

Pell Grants

The Budget proposes to make the Pell Grant program a mandatory spending program. In addition, it would fund its programmatic increases through changes in the federal student loan program. And in its August Mid-Session Review, the Administration proposes to make the increase in the 2009 stimulus package permanent.

Until recently, the Pell Grant program was entirely funded through the annual appropriations process, competing with other priorities for funding. The program distributes grants to lower-income students based on eligibility requirements set in law (as is the maximum award amount). All students who apply and meet the eligibility requirements receive a Pell Grant.

Unlike many benefit programs, the Pell Grant program is funded through the annual appropriations process, and its maximum grant amount is set in appropriations law. Funding for Pell Grants is provided for the upcoming school year in the current year's appropriations act and is available for two years. For example, the FY 2009 appropriations bill, which should have been enacted in calendar year 2008, provided the resources for the 2009–2010

academic year, and grants for that academic year will be awarded before the first semester begins.

Program advocates have struggled to obtain sufficient resources to meet the demand for grants. Since the Department of Education's budget request is made in advance of the academic year, it may underestimate need. As a result, it had to borrow from the next academic year's funds to meet its needs.

Rather than fully funding the program in the discretionary appropriations bill for the Department of Education, Congress and the executive branch have turned to mandatory spending as the solution. In 2007, President Bush and Congress provided "one time" mandatory funding to cover the shortfall and then created an "add on" mandatory Pell Grant increase. And in the recent Recovery Act, Congress and the president provided additional mandatory funding for the program and additional discretionary resources.

The president's proposal creates yet another new entitlement program that is exempt from annual congressional scrutiny while at the same time creating a major budgetary hurdle for Congress. The proposal ignores the congressional convention that requires an increase in mandatory spending to be offset with revenue increases or cuts in other mandatory spending. While the president can offset the creation of a mandatory program by moving the resources for the current program from the discretionary side of the budget, Congress cannot, and CBO has scored the program following that convention. In order for Congress to adopt the proposal to make the Pell Grant program mandatory, it would have to find program savings or increased revenue elsewhere. ■

Highway Trust Fund

In its February budget outline, the administration proposed changes to the Highway Trust Fund (HTF). The HTF provides resources for highway and mass transit construction and maintenance and is funded primarily through a fuel excise tax. The original outline proposed changes in the HTF that budgetary experts have long advocated. These changes would have simplified the budgetary treatment of highway spending by classifying all spending as discretionary and thus controlled by the annual appropriations process. Currently, the HTF is protected from competition with other programs because it has a dedicated revenue source and because congress-

sional budget rules grant it special treatment. That treatment maintains the illusion that the HTF is not fully a mandatory program and that it is subject to the annual appropriations process.

With a dedicated revenue source and its spending set in law by the authorizing committees, the HTF is similar to other mandatory programs. However, when designing the program, Congress created the HTF as a hybrid, giving both authorization and appropriations committees jurisdiction over HTF spending. It classified HTF budget authority as mandatory and its outlays as discretionary, which means that HTF spending is not subject to the controls on either type of spending.

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HTF contract authority, a form of budget authority, is considered mandatory spending, which is generally controlled by the authorizing committees. Most mandatory spending is subject to PAYGO, which requires offsets for any increases in proposed legislation. However, PAYGO applies only to mandatory outlays. And since HTF outlays are classified as discretionary, for reasons discussed below, PAYGO cannot be used to control HTF spending. While it is not subject to PAYGO, it is technically subject to the limits in the budget resolution on the amount authorizing committees can increase mandatory spending. However, as a practical matter, the authorizing committees have little trouble getting additional HTF spending into the budget resolution because highway spending is politically popular and any increase in HTF outlays is credited to the appropriations committees' allocation.

Congress did not move HTF spending entirely out of the annual appropriations process. While HTF budget authority is considered mandatory spending, the appropriations

committees control the annual limits on HTF obligations and thus, the outlays that result from those obligations are considered discretionary. Generally, programs that are controlled by the appropriations committees are pitted against other discretionary priorities because they are subject to an overall limit on discretionary appropriations—the so-called 302(a) allocation and the 302(b) sub-allocations for individual appropriations bills. However, since the House does not set enforceable outlay limits in the 302(b) allocations, highway spending slips through the cracks.

The tie between HTF excise tax revenue and spending has also been corrupted. Despite the original intent to limit HTF spending to its dedicated revenue source and the rule that prohibits HTF spending when the trust fund balance is at zero, Congress has provided multiple infusions from the general fund when demand has outstripped revenue. In 1998, Congress established the Revenue Aligned Budget Authority (RABA) to align HTF spending levels with actual trust fund revenues. The RABA provision requires the Department of Transportation to compare current revenue estimates to the original revenue estimates in the authorization bill and then adjust both contract authority and obligation limitations either upward or downward (negative RABA adjustment) to link revenue and expenditures. This worked reasonably well as long as the excise tax revenue kept pace with the previous year's spending (or increases in spending).

However, the HTF now generates insufficient revenues to pay for construction and maintenance expenditures, and policymakers have not scaled back transportation expenditures and in fact, have added resources for additional spending. So Congress either waives the RABA negative adjustment or ignores the trust fund principle entirely. It has funded highway spending through general fund emergency appropriations or else passed a law to direct an infusion of general fund revenue into the trust fund.

The administration initially proposed to simplify the budgetary treatment of HTF by making both HTF budget authority and the outlays discretionary spending under the control of the appropriations committees. This treatment would have counted obligation limits as discretionary budget authority and the contract authority like all other authorized levels, an approved amount rather than an appropriated amount. This change would have made HTF spending more transparent. Policymakers and the public

could have turned to a single appropriations bill, rather than a combination of authorization bills, appropriations bills, and spending outlays to gauge HTF spending.

As the revenue from gasoline taxes continues to decline, Congress faces growing pressure to maintain current spending levels by adding general funds to the HTF. If the administration and Congress continue to supplement gasoline tax revenues with general fund revenue, as happened in 2009, the HTF will, in fact, be competing with other priorities for general revenue dollars and will no longer be a true trust fund. If this practice continues, HTF spending (budget authority and outlays) should be subject to better budgetary controls. Scoring highway budget authority and outlays as discretionary could be one way to put transportation spending in the annual appropriations mix of budgetary trade-offs. At a minimum, Congress would be forced to make trade-offs between transportation and other discretionary spending that it often tries to avoid. Alternatively, if transportation authorizers want to maintain control over highway spending, they would need to seek other methods to oversee the program. If highway spending is a national priority, then the annual appropriations process can recognize that.

However, in the May budget, the administration was silent on its earlier proposal after the congressional budget committees rejected the shift, merely pledging to work on a “comprehensive approach for surface transportation reauthorization.” And although the administration has suggested delaying the reauthorization proposal until next year, it may not be able to forgo a fight for more general fund revenue for the HTF or the larger fight about the future of the trust fund.¹¹ ■

Aviation User Fee Charges

This administration, like its predecessor, has proposed to fund the nation’s air traffic control system through direct user fees rather than excise taxes on passenger tickets. Currently, excise taxes are levied on passenger tickets (as a percentage of the cost of the ticket) to fund the air traffic control services of the Federal Aviation Administration (FAA). Those revenues are deposited in the Airport and Airway Trust Fund.¹² This system is not based on the actual cost of providing air traffic control services to passengers and airlines, and places an undue burden on the larger airlines—which carry more passengers per flight than smaller airlines—and on the passengers who buy more expensive tickets.

Unlike the HTF, there is no statutory tie between excise tax revenues and the amount appropriated for the FAA’s operating budget in the discretionary appropriations bill. Congress appropriates funds for the FAA annually on the assumption that approximately 80 percent of the funds for FAA facilities, equipment, and airport improvements will be derived from excise tax revenue, and that FAA safety activities will be funded by general fund appropriations.¹³

The administration would continue to use general fund appropriations for some FAA activities but would tie user-fee revenue to air traffic control expenditures. Under its proposal (which is similar to the previous administration’s proposal), the FAA would set user charges based on a cost allocation model and designate the user fees and associated spending as discretionary spending.

The proposal creates a major budgetary hurdle for Congress. As with its Pell Grant proposal, the administration ignores the congressional hard line between mandatory and discretionary resources. Since FAA excise taxes are on the mandatory and revenue side of the budget, Congress, under its budget rules, cannot easily repeal these excise taxes and thus reduce revenue without identifying offsetting cuts in mandatory spending or revenue increases.

The previous administration faced similar hurdles with its aviation proposal and this administration has avoided a direct confrontation with Congress. While the Budget endorses the concept of user charges, it shies away from specifics: “the Administration recognizes that there are alternative ways to achieve these objectives. Accordingly, the Administration will work with stakeholders and the Congress to enact legislation that moves toward such a system.” ■

Acquisition of Financial Assets


The Budget also changes the budgetary treatment of certain financial transactions between the federal government and outside entities. These efforts are important in light of the growing role of the federal government in the credit and financial markets as a result of the recent financial crisis. The Budget estimates the long-term fiscal risk and benefits of the Troubled Assets Recovery Program (TARP) and tries to display those costs transparently. It records these transactions on a net present value basis. It also attempts to display the potential costs of the federal government’s purchase of Fannie Mae and Freddie Mac stock, and its commitment to the National Railroad Retirement Investment Trust.

However, this transparency does not extend to all transactions. For example, the Budget does not account appropriately for the cost of the U.S. subscription to the International Monetary Fund (IMF). Originally, the IMF protected the stability of member countries' currencies. However, it now is a multilateral development bank in which member countries participate in the making and guaranteeing of loans to other nations. That participation cost—the subscription rate—requires financial resources and in return, member nations acquire a portion of IMF assets (IMF loans). The IMF recently increased the subscription rate and now the United States must raise its contribution.

The administration argued that since the resources necessary to purchase a higher IMF subscription share are accompanied by an increase in the U.S. share of the IMF's financial assets the Budget does not need to include a cost for these transactions. These transactions, according to the Budget, are merely trades in types of financial resources—subscription rate (dollars) for assets (IMF loans)—and should be treated like the transactions between the Department of the Treasury and the Federal Reserve Bank. The Budget cites the 1967 President's Commission on Budget Concepts as its guide for how to treat these transactions.

However, these transactions are not as simple as the administration first argued. The increased subscription cost results in federal outlays, and the transactions are not just a financial asset exchange, but have real costs. The United States must outlay actual dollars for the increased subscription rate and may not see a full exchange of assets for those resources. And since the subscription makes the United States a partial backer of IMF loans (the financial assets), those resources may be needed to absorb the cost of any defaulted loans. In its negotiations with CBO and congressional staff on the IMF subscription rate, the administration admitted that IMF transactions might need to be treated differently in future budgets. And in the spring 2009 supplemental appropriations bill, Congress and the administration agreed to change the treatment of these transactions and the administration's August Mid-Session review reflects the new budgetary display.

In its future budgets, the administration should continue its attempts to improve the budgetary treatment of the long-term fiscal risk of the federal government's increasing role in the financial and credit markets, and in such institutions as Freddie Mac and Fannie Mae, and the Federal Deposit

Insurance Corporation. It should look closely at the Credit Reform Act for potential models. Since the act's passage in 1990, there has been improved transparency on the potential future cost of government loan activity in general, with the government calculating the risk when making loans and accounting for their risk-adjusted costs. 

Performance Budgeting

While the administration's commitment to making government more transparent and accountable is not, strictly speaking, budget reform, it has budgetary implications. If the federal government is to be more accountable, it must be more effective and perform better. Ideally, this will result in additional efficiencies and potentially lower costs. The Budget would end the use of the Program Assessment Rating Tool (PART)—a mechanism for measuring government program performance through a series of questions, measures, and targets that was implemented by the previous administration—and replace it with a new performance system.

Every administration has tried to improve government performance. The Clinton administration tried with its Government Performance and Results Act, and the Bush administration put forward its Management Agenda, with its accompanying red/yellow/green scorecard, and PART. Neither attempt to integrate program performance with budget outcomes was very successful.

Many observers saw PART as a step in the right direction, particularly as its implementation brought public and media attention to poorly performing programs. However, many agencies disliked PART and worried about the funding consequences of receiving a low score. They also felt that OMB did not fairly evaluate their programs and criticized the data OMB used to make its assessments. Ultimately, PART was never fully accepted as the means for evaluating program performance, and Congress and the appropriators rarely, if ever, used PART evaluations to make funding decisions.

The Budget would end the use of PART. However, it has not yet proposed an alternative, other than suggesting that the White House will work with federal agency heads and performance officers to create a new performance assessment model. On June 11, in its annual memorandum on the next year's budget, OMB asked federal agencies to develop by the end of July some high-priority goals that are

outcome oriented, short term (a year to two years), directly related to their mission, and with quantifiable measures and targets. The administration will likely continue to release additional details on how it plans to collect and use this information.

The administration will need a detailed performance-based budget model. While current budget practice focuses on justifying budget increases/increments, Congress and the president need to reexamine the base to ensure that resources are still being used wisely. And if the administration plans to propose tighter spending controls in future budgets, it will have to make funding trade-offs between existing programs, which should be based, at least partially, on performance. Agencies will also need to use these evaluation techniques to conserve resources and help them concentrate their efforts on high-performing programs. It remains to be seen whether the new model is a step backward from the previous administration's focus on program performance. ❖

Conclusion

The administration's first budget takes a few first steps toward establishing a more fiscally responsible budget process. The administration's proposal to reestablish a legally binding requirement to offset new initiatives and to apply it to both sides of the budget comes at a critical juncture when Congress is considering major legislation with profound budgetary implications. The inclusion of the estimate of future-year disaster spending makes its total request more realistic and credible. Its February proposal to use the appropriations process to control highway spending would dramatically increase the program's transparency. The Budget also resumes using ten-year budget projections, a very important step that highlights the longer-term consequences of today's policy decisions.

However, its proposals have certain deficiencies and some significant omissions. Its PAYGO proposal is undercut by the fact that it would exclude an extension of the 2001 and 2003 tax cuts, the AMT patch, and a freeze in Medicare reimbursement rates from PAYGO requirements. Its omission of caps on discretionary appropriations leaves a significant share of the budget without adequate controls. The jury is still out on its other proposals. It is an open question, for instance, whether the decision to eliminate PART to focus program assessment on priority areas is a reasonable approach or represents a general retreat on

the use of performance data in making budget decisions in deference to the appropriations committees and other congressional committees.

Other changes in the budget process may be needed in order to bring the long-term implications of budgetary decisions into focus. To this end and to its credit, the administration recently suggested establishing a BRAC-like commission to help control health care costs and has repeatedly raised the issue of the long-term consequences for the federal budget of the growth in health care costs. An independent commission could be immensely helpful in motivating Congress to make some of the tough budgetary choices that will be needed to improve fiscal conditions in the country. Congress and the president will need even more far-reaching proposals to put the nation's finances on a sustainable path.

The administration and Congress must address other deficiencies in the budget process. The federal budget should be more transparent on its procedures and requirements and have stronger enforcement mechanisms. There must be more discussion and substantive negotiations between the president and Congress on budgetary parameters. Policymakers also need to have better tools for evaluating the fiscal and macroeconomic implications of budgetary decisions and the long-term consequences of those policies.

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Notes

- 1 For a full description of the proposals, see “Chapter 15: Budget Reform Proposals,” in *Budget of the United States Government, Fiscal Year 2010, Analytical Perspectives*, May 2009, 215–20.
- 2 Commission staff used Congressional Budget Office (CBO) data from September 2002 (when the BEA PAYGO provisions expired) to September 2008 to calculate these percentages. CBO updates its estimates of baseline changes every six months and attributes those updates to legislative, economic, and technical changes.
- 3 “Letter from CBO Director Elmendorf to Majority Leader Steny Hoyer,” July 22, 2009.
- 4 “Table S-11. Mandatory and Receipt Proposals,” in *Budget of the United States Government, Fiscal Year 2010, Updated Summary*, May 2009, 21-27 and “Table S-11. Mandatory and Receipt Proposals” in *Mid-Session Review, Budget of the United States Government, Fiscal Year 2010*, August 2009, pp. 43-54. In fairness to the administration, this amount is associated with the net operating loss provision, which has a 10-year savings. In this case, the administration’s proposal to average the ten-year cost of proposals would have produced a savings in FY 2010.
- 5 “Reforming the Federal Budget Process,” CBO testimony before the Subcommittee on Legislative and Budget Process, Committee on Rules, U.S. House of Representatives, March 23, 2004, 9.
- 6 This refers to 45 days when Congress is in session.
- 7 A federal district court declared LIVA unconstitutional on February 12, 1998. This ruling was subsequently affirmed on June 25, 1998, by a 6–3 decision of the Supreme Court in *Clinton v. City of New York*.
- 8 Daniel Else and David Lockwood, “Military Base Closures: The 2005 BRAC Commission,” Congressional Research Service Report RS 22061, March 11, 2005.
- 9 “Table S-11, Mandatory and Receipt Proposals,” in *Mid-Session Review: Budget of the United States Government, Fiscal Year 2010*, August 2009, 49.
- 10 Rule 14 of the joint scorekeeping rules states that “no increase in receipts or decrease in direct spending will be scored as a result of provisions of law that provide direct spending for administrative management activities.”
- 11 *Budget of the United States Government, Fiscal Year 2010, Appendix*, May 2009, 905-908. The Budget assumes that a FY 2010 spending level equal to the FY 2009 spending level adjusted for inflation and requests discretionary appropriated dollars for the difference between that spending level and FY 2010 excise tax revenue.
- 12 “Financing Federal Aviation Programs,” CBO testimony before the Committee on Ways and Means, U.S. House of Representatives, May 7, 2009, p. 5. CBO estimates that passenger taxes account for about 89 percent of aviation taxes (with the remainder accounted for by cargo and fuel taxes).
- 13 *Ibid.*, 2.

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