Budgeting for Emergencies

The Peterson-Pew Commission on Budget Reform

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Peterson-Pew Commission on Budget Reform

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Summary

Emergency exemptions have been abused routinely to evade caps and satisfy short-term spending demands that add to the long-term fiscal burden.

Emergencies pose a special challenge to those seeking a more disciplined budget process because they are inherently unpredictable and because such costs vary widely from year to year. But, failure to incorporate a reasonable estimate of emergency needs in the budget both understates expected future spending and creates a potential loophole in any set of spending limits and controls. If this gap in the fiscal dike is not sealed, other reforms to shore up fiscal discipline will not hold.

In its November 2010 report, the Peterson-Pew Commission recommended that the budget include *expected* annual emergency spending in advance of actual losses by "… outlaying to an emergency reserve amounts sufficient to pay the expected average annual cost of emergencies, with strict rules governing the use of the emergency reserve."

For those not prepared to go so far, a middle ground approach would be to establish a reserve fund for emergencies, but reduce concerns that such a change would lead policy-makers to think that they have created a "free" pool of resources to draw on for non-emergency needs without adding to the deficit (since outlays would have been recorded as the reserve was built). In this case, budget authority would be scored when funds were appropriated to the reserve, but outlays and deficit effects would only be recorded as reserves were used, creating a political incentive to limit their use. As with the Commission's earlier proposal, withdrawals from the reserve would be required to meet the enacted definition of emergency uses, subject to presidential certification and congressional review, further discouraging abusive withdrawals.

If amounts adequate to meet future emergencies were routinely reserved, this would help the President and Congress enact policies consistent with projected resources. Budgeting these amounts annually would provide a truer projection of the fiscal outlook, and, by eliminating the need for emergency supplemental appropriations, close one of the biggest routes of escape from the budget discipline needed to stabilize the debt.

Introduction

Unanticipated budget requirements for Hurricane Irene and the financial demands of a feeble economic recovery are only the latest events raising questions about how the government should budget for emergencies. Emergencies pose a special challenge to those seeking a more disciplined budget process because they are inherently unpredictable and because such costs vary widely from year to year. On the other hand, failure to incorporate some reasonable estimate of emergency needs in the budget both understates expected future spending and creates a potential loophole in any set of spending limits and controls.

In the past, emergency exemptions have been abused to evade caps and satisfy short-term spending demands that add to the long-term fiscal burden of the U.S.[1] An extraordinary example occurred in July 2010, when the Census Bureau received $210 million in emergency funding to cover costs in excess of planned expenses for the 2010 decennial census.[2] The cost of the census had been estimated previously at about $10 billion, and most of this had been provided in regular appropriations. Some members of Congress argued against classifying this funding as emergency spending on the reasonable grounds that because the census must be performed every decade, it was impossible to view this spending as sudden or unforeseen.[3] The emergency funding was needed for costs of a management decision that had seemed likely but not certain when the regular appropriation was passed.

Prior to the enactment of the Budget Control Act of 2011 (BCA), all spending designated by the Congress as "emergency," including disaster relief, was exempt from existing budget limits, including caps on discretionary spending.[4] As a consequence, no emergency spending was paid for; its cost was automatically added to the deficit to be paid by future taxpayers and other stakeholders. Many observers had identified this practice as a significant contributor to uncontrolled spending and deficits.

Emergencies and the Budget Control Act of 2011

As a first step toward reasserting control over emergency spending, the BCA codifies the definition of "emergency" spending first developed by OMB in 1991.[5] The BCA distinguishes

[1] Concord Coalition, Growing Misuse of "Emergency" Designation Weakens Budget Discipline and Increases Deficit Spending," May 10, 2010 and General Accountability Office, (2008). Meyers, (1994) Chs. 4-5 identifies "misuse" of emergencies as a predictable consequence of strategic congressional behavior.

[2] http://www.nextgov.com/nextgov/ng_20080702_9517.php

[3] One participant in the debate reportedly scoffed, "George Washington could have told us there would be a census every 10 years." Coleman Bazelon, personal communication, June 10, 2011.

[4] Technically, the cap is raised to accommodate emergency spending.

[5] In 1991, OMB drafted criteria for identifying "emergency spending" under the Budget Enforcement Act of 1990 (BEA). OMB said emergency spending had to meet the following tests to appropriately be exempted from spending limitations established by the BEA: necessary—an essential or vital expenditure, not one that is merely useful or beneficial; sudden—quickly coming into being, not building up over time; urgent—a pressing and compelling need requiring immediate action; unforeseen—not predictable or anticipated as a coming need; and not permanent—the need is temporary.

"disaster relief" from other forms of emergency spending and caps an exemption of disaster relief from budget limits at its previous 10-year average.[6]

For fiscal year 2012, the Office of Management and Budget (OMB) calculated the maximum amount of exempt disaster relief would be $11.3 billion. Any spending for relief beyond that amount must be paid for by cuts in other spending. However, the ceiling applies only to emergency spending designated as "disaster relief." All other emergency spending remains exempt from the cap.

If followed strictly, BCA could force significant tradeoffs between disaster relief and non-emergency spending. If, for example, the period 2012-2014 were to replicate the pattern of disaster relief appropriated for 2004-2006 (Lindsay and Murray, 2009), Congress would have to reduce non-emergency spending by about $115 billion in fiscal 2013-14.[7]

Because the BCA excludes all emergency spending other than "disaster relief" from the pay-for requirement, it cannot ensure that even a portion of disaster relief will be offset within the capped totals. Under the Act, Congress might avoid the need to find offsets by designating up to $11.3 billion in spending as "disaster relief" and classifying other spending for that purpose as emergency spending. BCA gave voice to a bipartisan consensus for the urgent need to address the lack of control of emergency spending. But it provided only a potential first step toward an effective solution.

How Big is Emergency Spending?

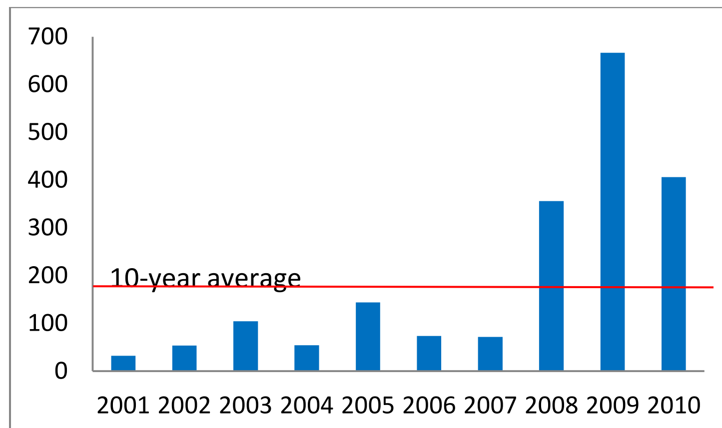
Disasters are one kind of "emergency", but only a small share of federal emergency spending is for disaster relief. During 2001-2010, the annual average of emergency supplemental appropriations, excluding smaller amounts provided in regular appropriations such as those for FEMA and foreign assistance, was $196 billion (Figure 1). Most was for defense and economic emergencies. Disaster relief accounted for about six percent of the total.

Unbudgeted disaster relief spending is a relatively minor contributor to federal spending and the deficit. The more inclusive category of emergency spending is a magnitude larger in size and is a threat to economic stability. Fixing the larger hole is likely to be more effective than a partial patch.

[6] The 10-year moving average excludes the highest and lowest annual values and is adjusted upward for any unused exempt amount of spending from the previous year.

[7] Emergency disaster relief appropriations by year were: 2004, $4.3 billion; 2005, $89 billion for Hurricanes Ivan, Jeanne, Katrina; and 2006, $55 billion for Hurricanes Katrina, Rita, and Wilma. Reductions of $71 billion and $44 billion would be required in 2013 and 2014, respectively.

Figure 1: Emergency Supplemental Appropriations, 2001-2010, billions of dollars



NOTE: Staff analysis. Methodology available on request.

An Alternative Approach

A more targeted approach to staunching the flow of red ink through the emergency designation was developed by the Peterson-Pew Commission on Budget Reform and described in their November 2010 report, ***Getting Back in the Black***. Specifically, the Commission recommended that the budget include *expected* annual emergency spending in advance of actual losses by "… outlaying to an emergency reserve amounts sufficient to pay the expected average annual cost of emergencies, with strict rules governing the use of the emergency reserve."[8]

Their proposal differs from the BCA treatment of emergencies in three significant respects. First, it includes all spending for which the Congress has used the "emergency" designation, rather than just disaster relief. Second, it proposes to recognize and pay for the expected cost of emergencies prospectively, as the budget is being developed, rather than after emergency events have occurred. And, third, like the BCA, the Commission proposal requires some but not all emergency spending be paid for. However, Peterson-Pew would require that the amount of spending offset be the moving historical average, not merely any annual excess spending above that average.

Of course, every legislative change requires majority political support and must be technically feasible if it is to constitute a remedy. How helpful are the changes in the BCA?

Paying Before or After

In concept, paying for emergency spending after a loss could be as effective as paying for the loss in advance. Practically, however, reaching agreement to offset the cost of disaster relief after an earthquake or other loss is too time-consuming to enable government to respond quickly when the need is greatest. To pay for a loss after the fact requires reductions in amounts of spending that have already been approved and incorporated into the budget plan. All available

[8] Peterson-Pew Commission on Budget Reform, 2010, *Getting Back in the Black*, p. 28.

monies have been allocated to favored uses. No Member will accept cutbacks in constituent benefits that have been negotiated and won only by making concessions to the claims of others. Agreement on how to pay for an unbudgeted loss may be as difficult as negotiating an entire new budget.

Hurricane Irene, which occurred between the passage of BCA and its 2012 effective date, provides a timely illustration of this practical difficulty. With the enactment of the BCA, Congress affirmed its intent to change the current practice of borrowing to pay the full cost of every emergency. Some costs were to be paid for by reductions in non-emergency spending. Consistent with this decision, a few members of Congress proposed that some or all of the federal cost of Irene be paid for as part of the legislation to fund assistance. That proposal was met with protests from members whose districts were affected by Irene, some of whom had voted for BCA. Their objection was that the need for federal assistance was immediate and could not await the outcome of an arduous negotiation to identify offsetting savings.[9] That shortcoming, however, is common to all emergency events. Sudden, urgent needs for federal resources are unlikely to be met by a process that requires agreement on a series of cuts to an enacted spending plan.

Paying for emergencies in advance of the loss event is a more timely way because the fiscal resources for expected needs for emergencies are included in the original budget plan. How much should be expected? If the BCA's approach of including a 10-year moving average of domestic disaster spending were expanded to include all emergency spending, it would be a good starting point. The Peterson-Pew recommendation was to include such an estimate in the President's proposed budget and the Congressional Resolution and to score that amount against the budget cap on discretionary spending. This requirement prevents all available funds from being allocated to non-emergency purposes before loss occurs.

Paying For Expected or Unexpected Spending

The BCA's pay-for provision has the appearance of a technical drafting error. It raises the discretionary cap for expected spending up to the 10-year average of disaster relief, but requires that above-average losses, including catastrophic events, be paid for by offsetting reductions in other spending. The traditional reason for not including emergency spending in the budget is that it is unpredictable. Giving a free pass to expected emergency spending while requiring offsets for unpredictable spending turns this logic on its head and requires payment only for unexpected losses. Paying for annual expected disaster relief assistance while deferring the cost of random variation, as recommended by Peterson-Pew, can ease the burden of greater fiscal discipline by avoiding the necessity of chasing self-offsetting year-to-year random variations in disaster relief.

[9] A perhaps less compelling argument offered against the proposal was that a requirement to pay for disaster relief is inconsistent with the American ideal that those who suffer loss can count on assistance from their neighbors who were spared. In fact, borrowing to pay for disaster relief honors a notion that few Americans accept, namely that all losses suffered today should not be paid for by neighbors but by unspecified future generations.

Details of the Commission's Proposal

The Peterson-Pew Commission's proposal is to include estimates of the expected annual cost of emergencies in the annual budget. Specifically, the Commission recommends that the government budget for emergency spending by:

- Including projected annual average spending for emergencies in the Allowances function of the President's budget request and the Congressional Resolution;
- Enacting mandatory permanent appropriations of the emergency allowance;
- Creating a single federal emergency reserve fund to be credited with the amount of budgeted allowances for emergencies.[10]
- Enacting a list of programs eligible to draw on the reserve fund for financing emergency outlays authorized under law. Use of reserve funds would be conditional on a presidential declaration and Congressional Resolution of need;
- Authorizing annual carry-over of unspent balances in the reserve fund;
- Providing permanent and indefinite borrowing authority for the reserve fund to make payments in excess of account balances for authorized emergency purposes. (This authority would be conditional on certification by the Congressional Budget Office, or another support agency charged with estimating expected annual average outlays, that spending remains within bounds consistent with an unchanged statistical distribution of expected costs); and
- Scoring all changes in law or policy affecting emergency spending with their annual incremental cost or savings, subject to all budget limits and enforcement procedures.

So long as policy and technical factors affecting the statistical distribution of emergency spending remain unchanged (adjusted for the value of covered assets), the expected budget cost of disaster policy could be routinely estimated. In years of extreme severity of losses in which authorized payments exceeded the reserve balance, the Treasury would advance funds to cover the deficiency. Repayment to the Treasury would occur in years in which disbursements are less than the expected value.

Increases in outlays resulting from liberalization of benefits or other changes in authorizing law would be scored to the responsible committee. Similarly, committees that report legislation to modify existing policy and reduce expected outlays would be scored with savings that could be authorized for other purposes, including risk reduction, mitigation, and non-emergency purposes. Changes in the underlying statistical models of cost would lead to mandatory re-estimates Transfers required to rebalance the fund would be scored as outlays or offsetting collections.

[10] Technical note: in assessing compliance of budgets with public debt targets, CBO and OMB would be instructed to assume that all funds in the reserve accounts would be disbursed during the projection period.

BOX 1: Some Previous Proposals to Budget for Emergencies

Many proposals have been offered by members of Congress, the President, federal agencies, and private analysts to budget for emergencies in anticipation of costs. For example, President Clinton in his budget for FY 1998 proposed creating a contingency emergency reserve fund for both natural and manmade disasters.[11] He requested annual funding equal to the average amounts by which the BEA spending caps had been increased to accommodate emergencies during 1991-97, or $5.8 billion.

He did not propose to pay for this reserve with spending cuts or tax increases now, but rather asked that the discretionary caps and deficit targets be raised by the same amount to permit this spending to occur. The proposed emergency fund would have been available for use by a specified list of executive branch agencies only if spending exceeded amounts assumed in their own budgets.[12] However, those funds would not have been available to the President until 15 days after he had given the Congress official notice of his intent to draw on the fund.

Eight years later, Douglas Holtz-Eakin (2006), Director of the Congressional Budget Office, noted in testimony before the House Budget Committee that government spending for Hurricanes Katrina and Rita would have to be paid for by some combination of spending cuts and tax increases, now or in the future. Absent any interest in paying now, he suggested that,

> The Congress may wish to consider options to incorporate planning for such events in the regular budget process. That planning may help evaluate policies for reducing the cost of future disasters and budgeting in advance for a greater share of those costs.

Most recently, President Obama, in his 2010 budget proposal, harshly criticized the budget practice of omitting expected outlays from the budget. He estimated that for the 2010 budget, those practices, if continued "…would show [falsely] in excess of another $250 billion annually in available funds" for spending on other purposes.[13]

As an alternative, the President requested funding for the projected cost of the wars in Iraq and Afghanistan, recognizing the "statistical likelihood of natural disasters instead of assuming there will be no disasters over the next decade, [and include] a contingency reserve as a placeholder in case further legislative action becomes necessary to stabilize the financial system."

His budget message continued, "If we do not account for [the costs of disasters and emergencies] as we project the future government's fiscal health, we run the risk of allowing these unforeseen events to cause even more economic pain and derail our long-term growth."
The President requested only $20 billion per year for emergencies, but he also projected a $250 billion contingent reserve for economic stabilization.[14]

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[11] *A New Era of Fiscal Responsibility, Budget of the Government of the U.S. for FY 1998 Appendix*, pp. 69-70.
[12] Those were Agriculture, Interior, Transportation, FEMA, SBA, and the Corps of Engineers.
[13] p. 36
[14] The President's budget also noted that repayments and future sales of securities would reduce the net cost of the financial stabilization effort to about one-third of the initial outlay. By that estimate, a projected $250 billion cost would support $750 billion in gross asset purchases.

Potential Advantages of the Commission's Proposal

Compared with current policy, the Peterson-Pew recommendation could decrease the risk of aggregate fiscal instability, increase the quality of individual budget decisions, raise spending for mitigation, and eliminate much misunderstanding of countercyclical fiscal policy and its relationship to long-term fiscal stability.

Increase Macro Fiscal Stability

Under current budget rules, dollars spent for emergencies are treated in the process as free. No current voter or stakeholder has to give up any non-emergency spending or taxable income for more emergency spending. Funds are borrowed now to provide assistance to be repaid later at some unspecified future time by unspecified generations. When faced with an opportunity to receive benefits without cost, people can reasonably demand additional emergency spending until the extra benefit from another dollar of spending approaches its perceived value of zero.

The danger of current policy is that it can also mislead lawmakers into acting as though emergencies are free in reality. If so, government may borrow and spend in excess of the amount that current or future taxpayers are willing to pay. This creates claims on federal revenue greater than the revenue the government is likely to be able to collect. This means that government has made promises it will not be able to honor. Default on the commitment to some stakeholders is inevitable. That is what analysts mean when they conclude that U.S fiscal policies are currently unsustainable.

The Commission's proposal would move to correct the perception that emergency spending costs less than non-emergency spending. By treating emergency and non-emergency spending as equivalent in the budget, the proposal could reduce the bias toward excess spending and borrowing for emergencies. Specifically, under this recommendation, lawmakers would choose a single cap consistent with planned revenues and a stable debt relative to national income. To make this feasible, the cap would have to be adjusted initially for the expected cost of emergencies.

One member of the Peterson-Pew Commission (Steuerle) identifies the tendency of lawmakers to continually spend in excess of likely revenues as the result of the failure to include some "slack" in the budget. His criticism of current policy extends well beyond the failure to budget for emergencies. Rather, he argues that if policy makers ignore the constant change in fiscal needs, they will be driven to overspend as unmet and unbudgeted new needs emerge from, for example, the changing age composition of the population.

Without some unallocated, saved resources, every shift in public preferences, whether emergency or non-emergency, creates gaps between budgeted spending and now-preferred spending. These gaps are extraordinarily difficult to close because all available resources have been promised to and claimed by other users and uses. Under the pressure of those new demands for public services, borrowing to meet all new needs is an attractive short-term option, even though it requires mortgaging future revenues. By saving and postponing the expected benefits of some non-emergency spending, we retain the flexibility to deal with changing circumstances, and avoid both losses from lower value spending and a growing debt burden over the long term.

Improve Individual (Micro) Budget Decisions

We budget because experience has taught us the inefficiency of sequential and uncoordinated spending choices. Making each decision on the basis of the merits of the immediate choice restricts our attention to the benefits of each single purchase, and thus leads to less than fully-considered decisions. In contrast, a proper budgeting process takes into account benefits and costs of alternative spending choices. Making spending decisions simultaneously based on the best estimates of the costs and benefits of all alternatives, including emergencies, increases the chances of making efficient choices about the use of limited fiscal resources.

The current separate treatment of emergency spending can encourage overspending for unexpected events, compared with what we might choose considering the benefits of spending on alternatives. The natural empathy toward those who recently have suffered loss makes the notion of "too much" assistance sound mean-spirited. Without a realistic budget cap or limit, the impulse to be generous to those in need can displace standards for a consistent and fair response across events.

Increase Incentives for Mitigation

Up-front scoring of the expected cost of emergency spending also provides budgetary incentives to increase federal investment in mitigation that reduces losses. This is important, because once the government accepts responsibility for assisting those who suffer losses we tend to reduce our own avoidance of and preparations for those losses.[15] As we save less and invest less in measures that could reduce our losses, we have more discretionary income and consume more. To compensate for those changes in behavior, or moral hazard, government needs to increase federal savings and mitigation commensurately.[16] Under current budget policy of open-ended borrowing for emergencies, however, government has only weak incentives to increase its own saving or mitigation to offset weakened incentives by households or other beneficiaries of disaster relief.

Without a change in federal saving and investment policy, the nation as a whole is likely to be less prepared for disasters than before federal assistance was offered. Less has been saved for the bad times, mitigation has been reduced, disaster losses are likely higher, and income and wealth are lower after the loss than with private budgeting for emergencies.

Increase Public Understanding of Deficits and Debt

The current budgetary treatment of federal countercyclical (emergency) fiscal initiatives can mislead the public and law makers about the need for changes in federal spending or taxes in recessions and economic booms. The federal government seeks to offset economic fluctuations using fiscal and monetary policies. Both automatic stabilizers and discretionary measures reduce tax revenues and increase spending during recessions. For this reason, as the economy moves into recession, the budget deficit widens. In booms, those policies increase tax revenues and lower spending and the deficit.

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[15] Hou and Duncombe (2008) find evidence of this effect on state and local governments who receive grants to replace infrastructure losses under the Stafford Act.

[16] Bohn (1996) finds evidence that the use of rainy day funds increases saving by state governments.

Increases in the deficit are popularly interpreted as inconsistent with long-term fiscal stability. Rising countercyclical deficits therefore elicit calls for pro-cyclical deficit reduction during a recession (and stimulative tax cuts and spending increases in a booming economy). In fact, attempting to reduce the budget deficit at the onset of a recession is likely to be counterproductive for both the recession and the deficit.

The Peterson-Pew proposal would replace the annual effect of economic and other types of emergencies on the current deficit with the annual expected cost of emergencies including economic fluctuations. That change would dampen the misleading signals about need for pro-cyclical fiscal policy during downturns and upswings.

Build on Existing Procedures

The core of the Peterson-Pew proposal, to include the expected cost of emergencies in the annual budget, is achieved in large part by recording outlays for this purpose in the existing budget function for allowances, but without offsetting that outlay effect with a credit to another function. The federal government routinely uses special budget accounts or "funds" to earmark funds for designated future spending. In enacting the Federal Credit Reform act of 1990, Congress changed budgeting for the cost of credit assistance, e.g. loan guarantees, by expanding the use of non-budgetary accounts to increase the transparency of expected costs. The use of a single reserve account also highlights the government's total requirement for savings to meet uncertain future needs.

Potential Disadvantages of the Commission's Proposal

The Commission's proposed reform may also have some effects that many will consider major disadvantages or fatal flaws. Those concerns include that advanced budgeting for emergencies is simply not feasible in an annual budget process, that the proposal would convert emergency spending into uncontrolled mandatory spending and that the existence of an emergency reserve fund will invite misuse of these monies and result in larger spending and deficits.

Lack of Feasibility

Budget analysts are now able to estimate long-term average emergency spending with reasonable accuracy assuming the continuation of current policy. However, they cannot accurately predict the year-to-year variation in emergency outlays. Some observers consider this inability to be a fatal obstacle to any attempt to budget for emergencies.

Their argument is that the U.S. budget is primarily a plan for controlling spending by federal agencies in a single year through annual appropriations. According to this view, when monies are obligated is as important to the execution of the budget as for what and to whom those obligations are extended. Exceptions to the single-year duration of the authority to spend are explicitly specified in law. The notion of appropriating money to be spent at some unspecified future date conditional on an uncertain event is inconsistent with annual budgeting. If our inability to predict annual spending for emergencies makes it impossible to budget in advance for this activity, then the current policy of budgeting for emergencies after the event is the only feasible means of dealing with unpredictable emergency spending in an annual budget. This

view also holds that the key to controlling spending for emergencies is to create rules that require Congress to pay for or offset emergency spending when it approves that spending.

The contrary view of the Commission as described above is that those who make the laws are unlikely to enact rules that will force themselves to do something they are loathe to do, such as to routinely overturn a prior agreement on taxes and spending whenever a costly emergency occurs. Further, the Commission does not believe that effective budgeting requires micro-control of annual obligations.

On the last point, consider disaster relief as an example. For disaster relief, effective budgeting means that whenever an emergency arises, the government's response is immediate, appropriate in scale to the event, and consistent with both the government's commitment and long-term fiscal balance. Currently federal policy meets most of those objectives. Consistency with planned deficits is the major exception. Current policy is largely successful because authorizing legislation (and associated regulations) specifies the conditions under which specific amounts and types of assistance are to be provided to eligible beneficiaries by designated agencies. Delays occur only if funds previously appropriated are insufficient and Congress is unable to agree to cover the funds. The amount appropriated is largely consistent with current law unless members decide to include extraneous funds for some unrelated purposes. However, the amount appropriated is rarely financed in a way that meets the budget plan for debt and deficits.

The Commission approach to budgeting for disaster relief and other emergencies would require modest changes in current practice to realize significant increases in effectiveness. The most important of these is to drop the requirement that the amount to be spent for disaster relief in the budget year be subject to appropriation in that fiscal year. Instead, the amount of spending for disaster relief in that year would be set by existing authorizing law and the severity and type of the disaster. This change would have little effect on disaster spending. That is because the amount currently appropriated for emergency relief—following receipt of agency estimates—is determined by existing authorizing law and the severity and type of the disaster. The drivers of outlays for disaster relief would be the same under current policy and the Peterson-Pew proposal.

Under the Commission's proposal, all emergency spending authorized under current law and policy would be disbursed as needed, and therefore with large annual variations in disbursements. It would be paid for with a highly stable annual outlay within a total budget constraint. If the estimate of expected emergency spending is unbiased, the cumulative sum of the annual differences from the annually appropriated amount would approach zero. If the estimate is found to be biased, a technical re-estimate could be used to correct this error. Subsequent future estimates of the annual, expected cost would be adjusted accordingly.

Loss of Control over Disaster Spending

The Commission's proposal would effectively convert emergency spending into a mandatory program. For those who consider mandatory programs uncontrollable through the budget process, this proposal would eliminate the only remaining restraint on emergency spending—discretionary appropriations. The Commission's view is that mandatory spending is controllable through reconciliation and that to restore fiscal balance this instrument will be needed as it was in the past.

Mandatory programs provide specified benefits to all who meet the eligibility requirements specified in authorizing legislation. Those programs often are intended to provide long-term benefits over the life cycle – for example, for student loans, Medicare—and form an economic safety net against economic hardship and deprivation, e.g., Medicaid, Social Security. Their roles in affecting people's lifetime plans make cutting promised benefits without significant advance notice unthinkable. Thus, reductions in benefits usually are effective only with a delay and phased in over several years.

Given the nature of mandatory programs, few budget savings can be achieved in the current budget year by enacting long-term changes in benefits. To control mandatory spending, lawmakers must take a longer-term view of budgeting and enact changes to authorizing legislation that are effective only when recipients have had time to adjust to new terms.

Emergency spending has a lot in common with other mandatory programs. The amount to be spent in a future budget year is unknown until the contingent event occurs; in the case of Social Security and disaster relief, for example, the number of people who will qualify for the benefits can't be determined in advance. In addition, in all cases it would be inconsistent with the intent of policy to pay benefits less than that promised because the amount appropriated was less than the requisite sum. To effectively control spending for emergencies or for mandatory programs, policy makers need to adopt a multi-year perspective.

The Commission's proposal to treat emergency spending like a mandatory program would increase the controllability of emergency spending by shifting from an ineffective control instrument, post-loss appropriations when funds are to be disbursed, to a more effective and politically feasible policy, pre-loss adjustments in the terms and conditions under which funds will be provided.

Misuse of Reserve Fund

Another concern is that federal funds cannot be set aside or reserved by government and that attempting to do so leads to increased spending for unintended purposes. The first part of this argument is that if government wants to accumulate resources for future use, it must purchase and hold private assets. That action is widely resisted because ownership of private assets is seen as an undesirable expansion of the federal role into the management of private assets. If government attempts to achieve the same purpose by earmarking federal funds in on-budget trust funds, as is done for Social Security, the money "saved" for one purpose could be spent for other purposes. Further, if government creates an on-budget reserve fund, voters may conclude that government has excess cash that ought to be returned, in lower taxes for example.

The federal government typically makes no attempt to accumulate resources in advance of future payments. It treats those obligations in the budget as having a cost in outlays and adding to the deficit only when they are paid. In a few cases, however, the government has attempted to fund future payments by counting set asides as federal spending that increases the deficit as money is saved. With this approach, no excess monies appear to be available for other purposes. In these cases, the government has had some success in saving for future payments. A key condition for success, however, is that the deficit and spending targets specified in the budget must be effective in restraining actual spending and borrowing. Examples of the second case include

amounts reserved to pay accrued interest on Treasury debt and, since 1992, to liquidate obligations for loan guarantees. This experience suggests that the capacity to save effectively for a specified purpose depends on congressional intent and on the budgetary procedures used to support the policy.[17]

State and local governments successfully set aside revenues for unexpected events. Those reserves are held in accounts referred to as rainy day or budget reserve funds to reduce the budget adjustments required in the event of economic downturns. However, in most cases, the amounts states reserve are small relative to the expected costs of economic emergencies (Joyce, 2001).

Variations on the Commission's Proposal

Some observers may believe the Peterson-Pew Commission recommendation for the budgetary treatment of emergency spending overreaches by proposing such extensive changes and moving faster than the political process can accommodate. To improve chances of some success, smaller changes might be made, introduced gradually, or a more traditional approach could be used to restrict use of emergency funding.

Increase Budget Coverage Gradually

One option would follow the BCA and begin with a small part of emergency spending, such as natural disaster relief. If this treatment proved feasible, it could be expanded gradually to include such items as flood insurance, deposit and pension insurance, some economic stimulus measures, and short-term defense emergencies.

Enforce a Strict Definition of Emergency

An alternative solution that also builds on the BCA would be to enforce the definition of emergency spending established by OMB in 1991 and now codified in law, as a first step to limit the amounts subject to special emergency treatment.

When Congress included the OMB definition of emergency in the BCA, it ratified a widespread agreement that these criteria constitute a useful definition and that emergency spending ought to be limited to cases meeting these conditions. Agreement on this principle, however, has proved insufficient to avoid disagreement in particular cases.

It will be difficult to bind Congress to a codified definition of emergency spending.[18] However, a point of order could be established in the Senate against any spending that as classified by CBO does not meet the statutory tests.

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[17] The 1983 amendments to the Social Security Act appear to be a mixed case: a change in Congressional intent without a change in budget accounting. The effect on government saving is difficult to assess. (Engen and Gale, 1997) and (Nataraj and Shoven, 2009). For a related discussion, see (Elmendorf, Liebman, and Wilcox, 2001.)

[18] The 2010 emergency supplemental had a more infamous precedent in the funding of the cost of the 2000 census for which the entire amount appropriated was designated as an emergency. The Conference report noted the Bureau's inability to accurately project its spending requirements and provide timely information to the Committees. Congressional Record V.145, Pt 21, November 17, 1999 – December 3, 1999, p.30190. Proponents of the

No Scoring of Emergency Spending

Another variation on the Commission's proposal would provide policymakers with estimates of the expected annual cost of emergencies, but only in a notional form where it would not affect the budget totals until spending occurs after the emergency. Yet another variation would be to show the estimated expected annual cost of emergencies in gross outlays, but to treat them as intra-governmental transfers, so they would not affect net budget authority, outlays or the budget deficit until funds were disbursed by the federal government to non-federal recipients.

Hybrid scoring of emergency spending

A middle ground approach would preserve the concept and much of the disciplining effect of establishing a reserve fund for emergencies, but avoid or reduce some of the objections that such a change would lead policy makers to believe they have created a "free" pool of resources that could be drawn on for non-emergency needs without adding to the deficit (since outlays would have been recorded as the reserve was built). In this case, budget authority would be scored when funds were appropriated to the reserve, but outlays and deficit effects would only be recorded as reserves were used, creating a political incentive to limit their use. As with the Commission's proposals, withdrawals from the reserve would be required to meet the enacted definition of emergency uses, subject to presidential certification and congressional review, further discouraging abusive withdrawals.

How the Recommended Approach Relates to Other Commission Recommendations

The budget process is widely seen as suffering from systemic failure. Changing only one component of a broken system, such as budgeting for emergencies, is unlikely to have much beneficial effect on system performance (Burman and Phaup, 2011). Realizing significant improvements from reform would likely require making other changes, including many of the recommendations of the Peterson-Pew Commission. Those include:

- Adopting a binding fiscal target or rule to constrain budget policies to a sustainable set;
- Renewing existing tools of budgeting that appear to have become moribund, including reconciliation; points of order, discretionary caps, PAYGO, and perhaps most importantly, a commitment by the leadership to *budgeting*;
- Integrating tax expenditures into the budget as mandatory spending;
- Improving budgetary accounting for deferred spending programs such as long-term insurance, pensions and other retirement benefits; and
- Increasing use of program evaluation and performance measures by the Congress in designing and improving specific policies and programs.

One process reform—to suspend the enforcement mechanism for medium-term debt/GDP targets following two consecutive quarters of negative real growth or other indications of economic downturn—would be less urgent if Congress adopted the recommendation for emergencies.

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emergency designation also cited a recent court decision that had imposed added costs on the Bureau. See www.washingtonpost.com/wpsrv/politics/special/budget/stories/spending072799.htm.

The Commission's recession circuit breaker was intended to avoid a pro-cyclical tightening of fiscal policy during economic downturns. However, this disadvantage would be avoided by muting the ability of the current budget deficit to incorrectly signal the need for pro-cyclical policies. An important effect of budgeting in advance for the possibility of economic contraction is that neither the target nor actual deficit would be much affected by a recession or financial crisis. The budget deficit would increase only if the Congress decided to increase stimulus beyond amounts produced by the operation of existing policy instruments that automatically generate higher spending during downturns.

BOX 2: Do we need to change the way we budget for emergencies to shift national consumption from good times to bad?

The Commission's recommendation aims to increase national saving in good economic times to provide the resources for increased consumption in bad economic times. Some analysts maintain that current policy can deliver those same benefits. In particular, they argue that budgeting in advance is not necessary to shift consumption from good, prosperous years (when one more dollar of consumption has a low value) to bad, low income years (when an extra dollar has a higher value). Current policy could achieve that result, if government borrowed to increase consumption in bad years and repaid the debt in future good years. Whether the good year precedes or follows the bad year is irrelevant because every good or bad year occurs both before and after the other.

This argument also draws on the fact that governments are better able to borrow than individuals during bad times. Government has this advantage because it can obligate future taxpayers to repay the government's debt. Individuals, by contrast, can commit only their own resources to future payments. Thus, government can borrow virtually unlimited amounts to maintain consumption in bad times without saving, provided it can credibly commit to repayment by future taxpayers.

No doubt, government could borrow in bad times and repay in good times. The open question is whether it could overcome the political obstacles to doing so. Future governments, voters, and taxpayers might choose to repay outstanding Treasury debt issued to pay emergency benefits to an earlier generation. Alternatively, they might decide that it would be more beneficial to pay interest only—the time value of money—and to defer the sacrifice of repaying the debt to a later generation of taxpayers. Taken by itself, deferral of debt repayment is benign.

However in the context of an apparent system bias in favor of spending now and taxing later (Moore and Redburn, 2011), a policy to "borrow in need and repay in better times" for emergencies adds to the unsustainable trajectory of debt and heightens the risk that creditors will lose confidence in the willingness and ability of government to repay its solemn obligations. Planned, disciplined borrowing to respond to a disaster is consistent with financial stability. But the use of borrowing as the institutional funding source in all circumstances can lead to calamity. Restraining the use of debt for non-emergency purposes, while maintaining the policy of borrowing the cost of "emergencies," would likely invite policymakers to designate more spending as eligible for favored treatment and create political barriers to paying for it later.

Conclusion

If Congress and the President were determined to smooth variations in spending arising from emergencies, they could do so without adopting the changes recommended by the Peterson-Pew Commission. Congress could match the long-term availability of fiscal resources to spending, including amounts to be saved for rainy days based on the newly codified definition of emergency spending, and adjust spending levels consistent with their priorities to what could be afforded. They might, if they chose, stick to such an affordable budget not just for a fiscal year but for a decade or longer. But, the present process discourages such prudent behavior; procedural reforms can make it easier.

Routinely reserving amounts adequate to meet future emergencies would help the President and Congress enact policies consistent with projected resources. Budgeting these amounts annually would provide a truer projection of the fiscal outlook and, by eliminating the need for emergency supplemental appropriations, close one of the biggest routes of escape from the budget discipline needed to stabilize the debt.

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