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Options For The Federal Budget Process

The Peterson-Pew Commission on Budget Reform

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PETERSON-PEW COMMISSION ON BUDGET REFORM

To modernize an outdated congressional budget process in light of the daunting economic challenges facing the nation, the Peter G. Peterson Foundation, The Pew Charitable Trusts and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 has convened the nation's preeminent experts to make recommendations for how best to improve the nation's fiscal future and how best to strengthen the federal budget process. The Commission began its work in January, 2009. In December of that year issued its first report, Red Ink Rising, and in November issued its second report, Getting Back in the Black. www.budgetreform.rg

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The Committee for a Responsible Federal Budget is a nonpartisan, non-profit organization committed to educating the public about issues that have significant fiscal policy impact. Its 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

Overview

For several years now, both observers of and participants in the federal budget process have seen that it is failing, even as the policy choices required to put the budget on a sustainable path grow more challenging. The publicly held federal debt is racing past 70 percent of the nation's gross domestic product (GDP) and projected to grow even more rapidly in coming decades, driven by the long-forecast retirement of the 'baby boomers' and continuously rising health care costs -- two of the biggest factors in what the co-chair of the President's Fiscal Commission Erskine Bowles calls, "the most predictable economic crisis in U.S. history." The darkening long-term outlook has so far been masked by investors' willingness to lend to the U.S. government at low rates. At any time, this could change; our situation then would be greatly complicated by rising interest payments, or by unpredictable but inevitable future economic or other emergencies demanding higher spending.

This fall, the Joint Select Committee on Deficit Reduction (popularly, the "Supercommittee") created by the Budget Control Act of 2011 tested the possibility that our fiscal challenges could be met by bypassing the regular process. The Supercommittee's collapse just before Thanksgiving points us back to the drawing board. We now must reconsider whether it is possible to reform the regular budget process, to help support those leaders prepared to make the tough choices needed to put the federal budget on a sustainable course.

Many have concluded that the federal government's governing institutions – and in particular the way it goes about budgeting – are not up to the task. The Peterson-Pew Commission on Budget Reform (hereafter "the Peterson-Pew Commission" or "the Commission") issued a report in December 2010, ***Getting Back in the Black***[1] calling on Congress and the President to pass a new "Sustainable Debt Act" that would establish a new budgeting regime.

The Commissions' approach to reform is realistic and practical. It also is bold, consistent both with the extent to which the process is broken and the scale of the fiscal challenges ahead. Recognizing the depth and political difficulty of the policy changes required to align spending and revenues over the decades ahead, the Commission has spent the past three years looking at ways to repair the process.

Many others, including the chair and ranking member of the House Budget Committee, have solicited new ideas and brought forward proposals. Frequently advocated reforms, such as a balanced budget amendment (BBA) to the Constitution or "biennial budgeting," have received fresh attention. Some experts have endorsed devices – similar to the Supercommittee – that would bypass the broken budget process. Certainly, it will not be easy to fix the regular federal budget process. Nor will process reforms magically produce agreement on a multi-year budget that is both supportive of economic growth and sustainable over the decades ahead. However, the Commission is convinced that in the long run only a federal budget process that is far-

[1] http://budgetreform.org/document/getting-back-black

sighted, disciplined, and transparent can hold leaders accountable for putting and keeping the budget on a sustainable path supportive of a vigorous economy and competitive in the world.

Fiscal Rules

Effective political leadership that forges public support for adherence to a fiscal rule is essential. One of the four papers released today discusses fiscal rules and their uses.

The Commission believes the basis for budget process reforms and for progress in stabilizing the debt must be agreement on a rule or target for fiscal policy. Preparing a budget without reference to a fiscal rule or target is like setting sail without a compass. Countries facing similar challenges – including Australia and Sweden – found it helpful to enact a fiscal rule as the first step in righting the fiscal ship. Here, there is no such practice. Therefore, the first task of U.S. leaders is to help restore a national norm of fiscal responsibility. Otherwise, any newly enacted rule will quickly succumb to the siren call of urgent demands for government to do more than it is prepared to pay for.

The Commission has advocated enacting a debt target for the medium term – and with it a comprehensive set of procedural changes intended to help policy makers adopt and sustain a multi-year fiscal plan to reach it. Its proposed "Sustainable Debt Act" would also require annual debt targets consistent with the medium-term target.

Multi-year Budgeting

Adherence to any fiscal rule must be supported by a process that provides discipline and focuses policy makers not on next year only but also on the fiscal horizon. Another paper released today outlines such a process.

As part of its comprehensive proposals last year, the Commission recommended strengthening procedures and institutions established by the Congressional Budget and Impoundment Act of 1974. This would enable House and Senate leaders, working through the Budget Committees and using the budget resolution and reconciliation procedures, to shape a multi-year budget that would meet the statutory targets. The resolution would set binding allocations for authorizing committees in order to prompt savings in mandatory spending and revenues, including tax expenditures.

The Commission recommends that, instead of the typical practice of passing a budget resolution that is focused only on the next fiscal year, Congress adopt a resolution for a multi-year budget plan that, once enacted, would remain in place unless or until further adjustments were required to meet the debt targets in the proposed Sustainable Debt Act.

Budgeting 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. Another paper released today looks at the practical options available to incorporate reasonable estimates of emergency needs in the regular process.

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. If this gap in the fiscal dike is not sealed, other reforms to shore up fiscal discipline will not hold. Annually reserving amounts adequate to meet future emergencies would help the President and Congress enact budgets consistent with projected revenues. In addition to giving a truer projection of the fiscal outlook, budgeting for these costs would largely eliminate the need for emergency supplemental appropriations, closing one of the biggest escape routes from budget discipline.

Budgeting for Better Performance

Another paper released today shows how budgeting can be made smarter, combining budget savings with more productive use of the more limited resources available. Resources must be allocated more wisely and only to the highest priority and most cost-effective uses.

To help with this, the Commission has recommended ways to make better use of information on program performance, including regular reviews to assess the cost-effectiveness of alternative programs and tax expenditures. It previously suggested that the Government Accountability Office be asked to regularly assess the effectiveness of selected groups of programs and policy instruments against their goals, and report regularly to the budget committees on opportunities to reallocate resources to more efficient and higher-return uses. The paper released today expands on these proposals, with special attention to the opportunities offered by the Government Performance and Results Act Modernization Act of 2010, which became law in January.

Summaries of the four papers being released today by the Commission follow.

Paper Summaries

Tied to the Mast: Fiscal Rules and Their Uses

A growing number of countries have established fiscal rules as a general guide to sound fiscal policy. The U.S. has not. The federal budget process has operated for a long time now without the discipline of a fiscal rule—formal or informal.

Surveys of such rules have shown they can help guide policy makers toward prudent budget choices and undergird more specific policies and procedures. By formally adopting such a rule, leaders choose to "tie themselves to the mast" of fiscal responsibility before they are fully exposed to short-term temptations to meet immediate demands and do what is popular.

Before any rule or set of rules can be enacted and sustained in the face of inevitable near-term pressures, public agreement must be obtained. In the U.S., traditional commitment to balancing revenues and spending has eroded.

One type of fiscal rule is a balanced budget requirement. A balanced budget requirement would not be practical if imposed immediately, given the federal government's current fiscal situation. Moreover, this or any other fiscal rule must be carefully designed to be flexible enough to deal with emergencies and economic cycles and yet not so flexible as to be meaningless as a standard.

For the medium term, the Peterson-Pew Commission recommends enacting a fiscal rule that would govern publicly held federal debt, in conjunction with the adoption of a broader set of budget process reforms such as presented in the Commission's 2010 report. This general fiscal rule would be reinforced by rules governing elements of the budget—caps on certain types of spending and tax expenditures and a strong version of the Pay-As-You-Go legislation. We also recommend a rule for the long-term that would align spending and revenues closely, taking into account economic cycles.

Adherence to a strong fiscal rule depends on whether it is grounded in public consensus about what constitutes sound fiscal policy. Because the traditional consensus that supported fiscal discipline has evaporated, the first task of U.S. leaders prepared to bind themselves to a fiscal rule is to help restore a national norm of fiscal responsibility. Otherwise, any rule will succumb to the siren call of urgent demands for government to do more than it is prepared to pay for.

Eyes on the Horizon: A Multi-Year Process for Federal Budgeting

The demise of the process established by the Budget Control Act of 2011 is not an ending, but a new opportunity to rethink the regular federal budget process. It is—or could be—the first step toward establishing a target for stabilizing the publicly held federal debt; an enforcement process to ensure that this and further debt reduction is achieved; and a credible, forward-looking process that will discourage myopic, unsustainable budgeting in the future. Further movement toward multi-year budgeting is consistent with the approach adopted in the BCA and necessary to build on what we have learned in that abortive effort to find a short cut to fiscal responsibility.

The most desirable way to establish multi-year budgeting and enforcement may be for Congress to enact legislation designed to ensure that any deficit reductions enacted (spending cuts or revenue increases) are not undone by subsequent actions. The legislation should specify medium- and long-term debt targets and a future debt path similar to those of the Sustainable Debt Act (SDA) recommended in The Commission's November, 2010, report.

The legislation would have two elements. First, it would include a multi-year debt target, putting the budget on a path to a debt no greater than 60 percent of GDP. Second, it would include annual savings targets, relative to the baseline, necessary to meet the multi-year target. The savings numbers would be the guiding, and enforceable, targets that would need to be met through enactment of subsequent budget legislation. Failure of Congress and the President to enact specific policy changes to meet the targets in the SDA would trigger the following enforcement actions:

- An automatic individual income tax increase (or percentage reduction in the value of tax expenditures) providing revenues equaling one-half of the savings target;

- Across-the-board spending reductions ordered by the Office of Management and Budget, covering all accounts (discretionary and mandatory) in the federal budget in equal amounts, and equal to one-half of the savings target.

This paper outlines a new process for multi-year budgeting, which assumes enactment of an SDA. Regardless of the details of design and implementation, the presumption underlying a multi-year budgeting process means that the budget is not merely a one-year plan to respond to short-term concerns, but rather a long-term plan that would move the federal government to a sustainable fiscal path, and then help it stay on that path going forward. Budgets should be developed and adopted with an eye to the horizon.

Budgeting for Emergencies

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.

Performance Budgeting

Facing major budget adjustments necessary to stabilize the debt, the federal government must find more productive ways to budget its diminished resources. To do more with less requires a new approach.

In this paper, the Peterson-Pew Commission on Budget Reform outlines a new way to budget that would allow spending and tax policy decisions to be informed by the relative performance of competing claims for scarce resources. Such an approach involves three elements:

- Measuring policy and program results;
- Identifying the highest policy priorities; and
- Instituting new budget procedures that apply evidence on results to decisions on how to advance the highest priorities.

Drawing on the experience of other nations and U.S. states, the paper suggests a possible sequence of steps to institutionalize consideration of performance during the budget process. It outlines a crosscutting "portfolio" approach that brings together in a single review process all tax and spending programs related to a common set of outcomes, in both the Executive Branch and Congress. These reviews would identify opportunities to drive improved performance through reallocation of resources and changes in policy.

A new "portfolio budgeting" process would reduce and reallocate resources to: (1) address the highest-priority national policy objectives; (2) redirect resources to more cost-effective approaches and higher-return investments; (3) leverage the government's contributions to improve the performance of governmental and non-governmental federal partners; and (4) increase transparency and improve public understanding of the budget. This more strategic approach to the budget also would inform priority setting and provide a bridge between broad policy aspirations and specific decisions on resource uses and policies to achieve them.

The Government Performance and Result Act Modernization Act of 2010 provides new opportunities to make effective use of performance information in the budget process. Its requirements for multiple agencies to plan and budget for cross-cutting federal priority goals and its alignment of strategic planning requirements with national electoral cycles and with federal priorities could, over time, support smart budgeting that shifts resources to higher priority and more effective uses.

Such an approach will only work if policymakers already have strong incentives to achieve savings on the spending and revenue sides of the budget. Accordingly, portfolio-focused performance budgeting must be implemented in the context of a plan to stabilize the debt while prudently using more limited budget resources to advance high priority public objectives.

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