

CBO TESTIMONY

Statement of
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NOTICE

This statement is not available for public release until it is delivered at 10:00 a.m. (EDT), Thursday, May 13, 1993.



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Mr. Chairman and Members of the Subcommittee, thank you for inviting me today to discuss budget enforcement changes that may be included in the upcoming reconciliation legislation. I will make three specific points in my testimony.

- o The Budget Enforcement Act (BEA), which was designed to enforce compliance with negotiated deficit reduction actions, has been more effective than Gramm-Rudman-Hollings, which was designed to force future policy actions to meet fixed, arbitrary targets.
- o This experience suggests that the most effective means of ensuring compliance with the actions included in this year's reconciliation bill will be to maintain the general outlines of the BEA, including the discretionary spending caps and the pay-as-you-go process.
- o Although enacting the deficit reduction envisioned by the 1993 budget resolution represents an important step, those actions alone will not be sufficient to control the deficit in the long run.

HOW THE BUDGET PROCESS AFFECTS DEFICIT REDUCTION

Since 1985, the primary focus of the budget process has been on establishing rules specifically focused on deficit reduction. This role for the budget process is codified in two major laws: the Balanced Budget and Emergency Deficit Control Act of 1985 (popularly known as Gramm-Rudman-Hollings) and the Budget Enforcement Act of 1990. The approach taken in 1990, when the BEA was passed, has been much more successful than that included in Gramm-Rudman-Hollings.

Gramm-Rudman-Hollings had a simple goal--to reduce the size of the deficit to specified levels each year until expenditures were in balance with revenues. If annual deficit targets were not met by enacting the appropriate amount of spending restraint or tax increases, automatic across-the-board spending cuts (or sequestration) were to take effect. According to the targets specified in the original legislation, the budget was to be balanced by fiscal year 1991. The first Gramm-Rudman-Hollings law was amended in September of 1987 to delay the target for budgetary balance until fiscal year 1993.

The deficit, of course, has not come down as promised by the Gramm-Rudman-Hollings legislation. In an effort to live within the short-term budget constraints, the President and the Congress evaded the targets by relying on

overly optimistic economic assumptions and outright budget gimmickry. This smoke-and-mirrors strategy enabled policymakers to appear to live within the annual constraints, while doing little to reduce the actual deficit. For example, the original deficit target for 1990, the last year the Gramm-Rudman-Hollings procedures were fully in place, was \$36 billion. The revised 1990 target, established in 1987, was \$100 billion. The actual deficit for that year was \$220 billion. The deficit for 1993 (the year in which the revised targets were to require a balanced budget) will probably approach \$300 billion.

The BEA created a quite different kind of process than Gramm-Rudman-Hollings. It was enacted to enforce compliance with the deficit-reducing actions agreed to at the 1990 budget summit, but not to force further reductions or to compensate for unrealized expectations about the economy. Moreover, the BEA focuses on controlling legislative policy actions that would cause the deficit to increase. Two separate procedures were set up to achieve this end. The first is the discretionary spending caps, which place limits on the level of budget authority and outlays through 1995. The second is the pay-as-you-go (PAYGO) process, which requires that Congressional actions affecting mandatory spending or revenues be at least deficit neutral.

By and large, the Congress and the President have lived within the BEA's constraints. Although the deficit outlook has deteriorated since the 1990 budget agreement, this turn of events is not the result of any failure of the BEA. The deterioration of the economy and technical reestimates of revenues and spending, especially for Medicare and Medicaid, are largely responsible for the increase in the projected deficit since 1990. That virtually none of the changes in the deficit outlook result from policy actions is a testimonial to the success of the BEA (see Table 1). The BEA did not, however, include any procedure to reconsider the rules were the deficit outlook to deteriorate.

The past seven years have provided an experiment in the efficacy of two very different approaches to using the budget process to reduce the deficit. Although neither Gramm-Rudman-Hollings nor the Budget Enforcement Act has resulted in the anticipated deficit reduction, several lessons emerge from the actual results under each regime. These lessons should guide any search for a process to enforce the deficit reduction actions included in the 1993 reconciliation legislation.

TABLE 1. CHANGES IN CBO DEFICIT PROJECTIONS SINCE THE 1990 BUDGET SUMMIT (By fiscal year, in billions of dollars)

	1991	1992	1993	1994	1995
December 1990 Projection	253	262	170	56	29
Policy Changes					
Revenues	-1	3	5	a	a
Outlays					
Desert Storm spending ^b	23	13	10	2	1
Desert Storm contributions	-43	-5	0	0	0
Other emergencies	1	2	5	1	1
Other discretionary appropriations	0	-2	-5	0	0
Entitlement legislation	<u>a</u>	<u>7</u>	<u>4</u>	<u>1</u>	<u>a</u>
Subtotal	-19	15	14	4	2
Deficit	-19	13	9	4	2
Economic Changes					
Revenues	-31	-58	-78	-90	-102
Outlays	1	-9	-31	-38	-34
Deficit	32	49	47	52	68
Technical Changes					
Revenues	-24	-38	-43	-39	-37
Outlays					
Deposit insurance ^c	-28	-108	-37	46	37
Medicaid and Medicare	7	19	32	45	60
Other major benefit programs	8	18	24	24	25
Debt service	-1	-2	a	7	18
Other	<u>-7</u>	<u>1</u>	<u>13</u>	<u>12</u>	<u>9</u>
Subtotal	-21	-71	32	134	148
Deficit	3	-34	74	174	185
Total	16	28	131	230	255
Current Projection	270	290	302	287	284

SOURCE: Congressional Budget Office, March 1993.

NOTE: The December 1990 projections appeared in Congressional Budget Office, "The 1990 Budget Agreement: An Interim Assessment," CBO Paper (December 1990).

a. Less than \$500 million.

b. Estimated; Desert Storm outlays are not segregated from other defense outlays.

c. Excludes changes in estimated interest paid by two deposit insurance agencies (the Resolution Trust Corporation and the Bank Insurance Fund) to the Treasury. These payments are intrabudgetary and do not affect the deficit.

- o First, budget procedures are much better at enforcing deficit reduction agreements (as the BEA has) than at forcing such agreements to be reached (as Gramm-Rudman attempted to do). The experience under Gramm-Rudman-Hollings demonstrated that if the President and the Congress are unwilling to agree on a painful deficit reduction package, a budget procedure is unlikely to force them to agree. Conversely, if the President and the Congress agree on and enact a painful package of spending cuts and tax increases to reduce the deficit, budget procedures that highlight and penalize deviations from that agreement can be effective.

- o Second, participants in the budget process should be held accountable for results that are under their direct control. The BEA contributed to that end by creating different enforcement procedures for discretionary spending than for mandatory spending and revenues. One of the problems with Gramm-Rudman-Hollings was that the fixed deficit targets made it virtually impossible to identify any budget participants who were responsible if the deficit was estimated to exceed the target. However, both

Gramm-Rudman-Hollings and BEA had flawed accountability structures in one sense, since they each exempted a great many programs from sequestration. In contrast, accountability is encouraged by having a large sequestration base; without such a structure, advocates of programs exempt from sequestration have incentives to resist policy changes that would affect their programs.

- o Third, any enforcement process must be credible. Gramm-Rudman-Hollings lacked credibility because it promised results that proved virtually impossible to achieve, and it invited evasion through phony estimates and budget gimmicks. The BEA is more credible than Gramm-Rudman-Hollings because it promises only to prevent legislative changes that would diminish the deficit reduction put in place by the 1990 budget agreement. In addition, the automatic sequestrations that enforce the BEA are credible because they are likely to be relatively small.
- o Fourth, the process must include a certain amount of flexibility to allow reasonable responses to unexpected

events. For example, the federal government often needs to engage in countercyclical fiscal policy or to respond to other emergencies, such as natural disasters or international crises. The BEA provides flexibility by establishing an explicit exception for discretionary appropriations, mandatory spending increases, or tax cuts that the legislation and the President designate as emergency requirements.

**WHAT BUDGET PROCESS ACTIONS
SHOULD ACCOMPANY THE 1993 RECONCILIATION LEGISLATION?**

The most successful recent experience with long-term deficit reduction--the 1990 budget summit--coupled agreement on a specific long-term deficit reduction plan with a process to ensure that future appropriations for discretionary spending do not exceed the planned amounts and that future changes in mandatory spending programs and taxes do not dissipate the deficit reduction that has been enacted. To the credit of the President and the Congress, that same general process has been followed this year. The first part of the deficit reduction formula was achieved by enacting a budget resolution that included a plan for reducing the deficit. This plan will come

to fruition by enacting legislation that puts specific tax increases and spending cuts into effect.

Any enforcement legislation included as a part of the 1993 reconciliation bill should embrace the general guidelines of the Budget Enforcement Act. In other words, the bill should extend the discretionary spending caps and the PAYGO process. It should also extend various temporary provisions of the Congressional Budget Act, such as multiyear spending allocations and enforcement, that have strengthened the BEA. In addition, any new enforcement procedures should drop the fixed annual maximum for the deficit. In practice, the maximum deficit amounts included in the BEA have been irrelevant, since they have been adjusted to reflect changes in economic or technical factors. Beyond the general framework of the process, however, there are several factors to consider, including the structure of the discretionary spending caps, the enforcement window and sequestration base for PAYGO, and whether or not a separate deficit reduction trust fund should be created.

Discretionary Cap Issues

If the Congress chooses to enact new caps on discretionary spending, it must address at least two questions. First, should there be a single cap on all discretionary spending or should there be separate caps for different spending categories? Second, should caps exist on both budget authority and outlays?

The Budget Enforcement Act placed separate caps on domestic, international, and defense discretionary spending through fiscal year 1993, and a single cap on all discretionary spending for fiscal years 1994 and 1995. The Congress must decide whether to take one of these two approaches, or some other approach, in enacting new discretionary caps. This decision does not hinge on the economic effect of single versus multiple caps, but on other factors. Arguments in favor of multiple caps usually come from those who want to protect some category of spending (such as defense) from further reductions, or from those who wish to ensure that any further reductions in a given category are used for deficit reduction, as opposed to increasing spending in some other area. The argument in favor of a single cap hinges mainly on flexibility. Given current rapid changes, a single cap would help the Congress and the President to respond to unforeseen circumstances.

The BEA also established separate budget authority and outlay caps. More recent proposals for enforcement, such as that advanced by Representative Penny (in H.R. 998), would cap only budget authority, without imposing a separate cap on outlays. Proponents of a single cap maintain that capping both budget authority and outlays is redundant at best. The redundancy results from the fact that outlays represent the future liquidation of budget authority; thus, limiting budget authority will, in the long run, limit outlays.

Moreover, some of the practices that have been engendered by the existence of outlay caps have proved counterproductive. For example, some appropriation bills have dealt with the necessity to meet strict outlay caps by delaying obligations into the future, thus making the out-year problem worse. Another distorting practice is letting outlay targets force choices on budget authority to be made on the basis of spend-out rates for competing programs. Conversely, since the deficit effect of spending is recognized not by budget authority but by outlays, a cap only on budget authority might not achieve the level of reduction in discretionary spending set out by the budget resolution for a particular year as effectively as having two separate caps might.

At the very least, relying on a budget authority cap alone requires redefining budget authority, since some discretionary outlays are not now

controlled by discretionary budget authority. Even there, the relation between budget authority and outlays would not always be a tight one.

PAYGO Issues

As the Congress evaluates the specific structure of PAYGO, its most important issue will be to decide on the length of time for which PAYGO is extended and the duration of the PAYGO scorecard. Under current law, although PAYGO is enforced one year at a time, the effect of direct spending and revenue legislation on the deficit is entered on a PAYGO scorecard that runs through fiscal year 1995. Consequently, the closer we get to 1995, the easier it becomes for proponents of reduced taxes or increased mandatory spending to push the cost of their proposals beyond the PAYGO window.

One idea that has surfaced in response to this shortcoming is to enact PAYGO for ten years rather than five. But estimating the effect of current legislation on spending or taxes for more than five years from now leads to increasingly uncertain estimates that might undermine confidence. The PAYGO discipline could extend beyond five years by instituting a five-year rolling scorecard. Under such a regime, estimates for changes made in the fiscal year 1994 budget cycle could be made for 1994 through 1998, changes

enacted in 1995 would be scored for 1995 through 1999, and so on. For at least five years, this approach would prevent proponents of changes from avoiding enforcement by pushing costs out just a couple of years. At the same time, it would thwart jeopardizing the whole process in a morass of unreliable estimates.

A second issue with PAYGO concerns the base that can be used for sequestration. The Budget Enforcement Act subjected a rather narrow base of mandatory programs to across-the-board cuts if PAYGO requirements were not met. This procedure has worked fairly well and might be maintained. But the Congressional Budget Office has argued elsewhere that the best way to build consensus on actions to reduce the deficit is to ensure that the effects of such actions are spread broadly. A broader base would exist, for example, if all mandatory programs were subject to sequestration, or if automatic tax increases were triggered by a breach of the PAYGO discipline. Without a broad base, supporters of exempted programs would not find it in their interest to cooperate in achieving any consensus on policy changes, since their programs would not be adversely affected by a sequestration. Broadening the base gives everyone a stake in adopting a reasoned action plan.

Enforcement legislation that spreads the budgetary pain broadly, then, is generally preferable to one that singles out specific programs for large

reductions. In addition, a broad base makes the enforcement procedure more credible by lessening the size of reductions in individual programs that would occur as a result of sequestration.

Should a Deficit Reduction Trust Fund Be Created?

Proposals have been made to establish a trust fund earmarked for deficit reduction. Under this concept, all revenue increases and savings from spending cuts that were included in the budget resolution would be placed into this trust fund. The apparent purpose of this change would be to assure the public that the tax increases and spending cuts included in the resolution would actually reduce the deficit.

As a matter of fiscal fact, any tax increase or spending cut reduces the deficit relative to the level that would have existed without that action. But saying that deficit reduction has occurred is different than achieving particular deficit targets, and creating such a trust fund could not ensure any particular deficit outcome.

Consider the experience under the 1990 budget agreement. The Congress enacted tax increases and spending cuts that totaled almost \$500

billion over five years. At the same time, it enacted procedures to ensure that this \$500 billion in savings was not undone, and indeed these procedures have been followed. Nonetheless, current projections are that while approximately \$500 billion in savings was achieved, the anticipated deficits were not reduced accordingly.

What is the cause for the difference? It is almost exclusively the result of changes in the economy and in technical assumptions concerning programs such as Medicare. Placing the tax increases and spending reductions into a trust fund would not have changed that outcome. Accordingly, establishing such a trust fund to accompany this year's reconciliation bill would not ensure that the deficits projected by the budget resolution would come true. In fact, no action can guarantee achieving a specific future deficit level. The pertinent insurance policy is strong enforcement of the cuts agreed on.

Strong enforcement of existing agreements could be supplemented by procedures triggering the consideration of further actions, without creating a trust fund. The Congress could, for example, require the President to submit a plan for enacting additional deficit reductions should the deficit outlook deteriorate in any way. The Congress and the President would not be required to take deficit reduction actions, but would be required to actively consider doing so.

BEYOND THE 1993 RECONCILIATION BILL

I believe that extending BEA-like enforcement procedures is the most effective alternative available for the budget process. However, the process places a heavy responsibility on the President and the Congress to determine each year whether additional deficit reduction is necessary. In 1990, this responsibility may not have seemed so great: many people hoped that merely enforcing the deficit reduction set out in the budget agreement would put the deficit on a long-term downward path.

In 1993, there is no such hope. Implementing this year's budget resolution would reduce deficits from an estimated \$300 billion in 1993 to \$193 billion in 1997. Under the budget resolution policies, however, the deficit will begin rising again--to \$202 billion in 1998. Further, the deficit is expected to continue to increase beyond 1998. Therefore, at least one more round of similar deficit reduction will be necessary to bring the deficit under control, even if the current budget resolution savings are enacted in full.

Extending the mechanisms to enforce the BEA does not imply that additional deficit reduction is not necessary. It should imply, however, that the President and the Congress have accepted the responsibility to enact additional savings in the future.