CBO TESTIMONY

Statement of
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NOTICE

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Chairman Kasich and Members of the Committee, thank you for inviting me to testify today on the federal budget process. The overall message of my testimony is that the budget process is working reasonably well as a framework for making and enforcing budgetary decisions. Evidence often cited as proof of the failure of the budget process in fact reflects political disagreement over particular budget policies or outcomes that the process cannot--and probably should not--control in the absence of broad political agreement. With this overall theme in mind, I will briefly review the evolution of the federal budget process, discuss some tentative lessons that can be drawn from recent budgeting experience, and assess some of the recurring criticisms of the process and related reform proposals.

THE BUDGET PROCESS WORKS

Fundamentally, the budget process works well. Although the record of Presidential vetoes of major budget measures last year and continued budgetary conflict this year would seem ample cause for a less enthusiastic endorsement, those difficulties and other evidence of the failure of the budget process involve matters beyond the control of the process. In recent years, the budget process has not only accomplished the basic purposes for which it was created, it has also displayed certain virtues that should be preserved in any reform effort.

Last year, for example, the Congress adopted a historic budget resolution recommending a balanced budget by fiscal year 2002. It then proceeded, without inordinate delay, to develop and approve reconciliation legislation, appropriation measures, welfare reform legislation, and other landmark measures that were consistent with the resolution and that the Congressional Budget Office projected would achieve the resolution's balanced budget goal. The Congress is on a similar budgetary track this year: it has approved another balanced budget resolution and is proceeding with appropriation and reconciliation measures to carry it out. Thus, using existing procedures, the Congress has been able to accomplish the most fundamental and perhaps the most important function of the budget process--to establish and enforce a comprehensive budget plan for the federal government.

Critics of the budget process point to different evidence. Last winter, the President vetoed the reconciliation and welfare reform measures that included most of the policy changes necessary to follow through on the budget resolution's recommendation for a balanced budget. The Congress and the President were unable to reach final agreement on funding levels for major federal programs for the current fiscal year until this past spring, when the fiscal year was already half over. That disagreement led to two partial shutdowns of the federal government, required the Congress to enact a record number of continuing appropriation acts, and delayed essential legislation increasing the limit on the public debt. This year, critics say, is shaping up as a repeat of last year's failure.

Yet much of the apparent failure of the budget process over the past year or so actually has been a product of political disagreement between the President and the Congress over budget priorities. That disagreement has not been the result of inherent flaws in the budget process. The budget process is not designed to force certain outcomes without broad political agreement or, conversely, to obstruct those outcomes when agreement has been reached.

Rather, the budget process provides a framework of rules and procedures that generally serves as a conduit for majority rule. The process establishes a structure in both the executive and legislative branches for disseminating budget information, and for developing and enforcing budget plans for the federal government. In the Congress, it also provides a means of coordinating the actions of committees. More expansive, policy-oriented goals for the budget process, without political agreement on how to reach those goals, ask more of any budget process than can be delivered.

HOW THE FEDERAL BUDGET PROCESS EVOLVED

The modern budget process is an amalgam of procedures and practices set forth in various statutes and in Congressional rules of procedure. Principally, however, it is established in two laws, as amended--the Budget and Accounting Act of 1921 and the Congressional Budget and Impoundment Control Act of 1974. The former

provides for an executive budget process centered around the annual submission of a budget proposal by the President. The latter provides for a Congressional budget process centered around adopting and enforcing a concurrent resolution on the budget by the Congress.

The basic accounting rules generally followed in the modern budget process are set forth in the 1967 *Report of the President's Commission on Budget Concepts*. Although the report has no legal status, it remains to this day the most authoritative statement on federal budgetary accounting concepts and principles. The commission's most important recommendation was for a comprehensive budget with few exclusions. It recommended that the budget generally cover the full range of federal activities and that even borderline activities and transactions be covered unless there were compelling reasons to exclude them.

The basic purposes of each of the major budget statutes correspond to the constitutional roles and responsibilities of the respective branches of government to which they apply. The Budget and Accounting Act of 1921 requires the President to submit an annual budget setting forth his proposals in detail for the upcoming fiscal year. Because under the Constitution the President heads the executive branch, the act establishes procedures to ensure that the President's priorities prevail in his annual budgetary submissions.

The Congressional Budget Act of 1974 establishes a Congressional budget process for the Congress to set forth its own budget. That law was enacted both in response to the frustration generated by the fragmented nature of Congressional spending and revenue decisions and as a way to enable the Congress to carry out its constitutional budgetary responsibilities more effectively. The law also established new procedures to control impoundments of appropriated funds by the President.

The Congressional Budget Act established a framework within which the Congress could establish and enforce its own budget priorities, and against which it could judge the budget priorities of the President. Thus, it created the House and Senate Budget Committees to coordinate Congressional action on the budget, and established the Congressional Budget Office to provide the Congress with nonpartisan information and analysis on the budget and the economy.

Because power in the Congress is dispersed, the Congressional Budget Act established a procedural mechanism for bringing majorities in the House and Senate into agreement on a budget plan. It did so by providing for the Congress to adopt annually a broad, nonspecific concurrent resolution on the budget. The budget resolution is not signed into law; it serves only as a guideline for Congressional action on actual legislation on spending, revenues, or the debt limit.

Different majorities in the Congress have used the budget resolution for different policy goals. Budget resolutions have recommended both tax cuts and increases, entitlement cuts and expansions, and annual appropriation cuts and increases. Moreover, majorities in the Congress have also modified budget resolution procedures to accomplish their policy objectives. For example, a change in budget resolution practices in 1981 converted the reconciliation process from a limited, seldom-used procedure to a potent new tool for conforming permanent spending and revenue law to the priorities established in the budget resolution. More recently, budget resolutions have included procedures, such as so-called reserve funds, that permit the Congress to consider certain deficit-neutral policy initiatives.

The most significant recent changes in the budget process have been made over the past decade or so to reduce and control the deficit. Initially, those changes met with limited success, in part because they may have asked more of the budget process than it could reasonably deliver. More recent revisions in those procedures seem to have put in place deficit control procedures that the budget process can more realistically accommodate.

In 1985, the Balanced Budget and Emergency Deficit Control Act became law. Known as the Gramm-Rudman-Hollings Act, or GRH, it established a firm schedule of declining deficit targets that called for eliminating the deficit by fiscal year 1991. It established a procedure--known as sequestration--to make uniform

percentage reductions in spending that would be triggered if the targets were not met. Moreover, it amended the Congressional Budget Act of 1974 to ensure that Congressional action on the budget resolution would be consistent with the new statutory deficit targets.

In the years that followed, budget resolutions were adopted that met the deficit targets, and spending and revenue legislation was enacted that was projected to meet the targets. Nonetheless, actual deficits generally failed to reach the targeted levels. For example, the actual deficit for fiscal year 1991, the year originally set for a balanced budget, was $270 billion. Although different reasons are cited for the failure of fixed deficit targets--including reliance on excessively optimistic economic and budget estimates--a more fundamental shortcoming was that the prevailing political consensus did not support the policies needed to attain the targets.

In the fall of 1990, the Congress and the President amended the GRH act and the Congressional Budget Act to put in place procedures that established a new philosophy of deficit control for the budget process. Set forth in the Budget Enforcement Act of 1990 (BEA), those new procedures no longer tied a balanced budget goal to a fixed deficit target. Instead, the BEA established annual limits on total discretionary appropriations and a deficit-limiting pay-as-you-go (PAYGO) requirement for mandatory spending and revenue legislation through fiscal year 1995. If discretionary appropriations were enacted that exceeded annual limits, or

if mandatory spending or revenue legislation was enacted that caused a net increase in the deficit for a fiscal year, a sequestration would occur to eliminate the excess amount or deficit increase. The discretionary spending limits and PAYGO requirement were extended through 1998 in the Omnibus Budget Reconciliation Act of 1993.

Unlike the fixed deficit targets under the GRH act, the discretionary spending limits and PAYGO requirement have been met. The limits and the PAYGO requirement have been honored in each fiscal year, and they have generally been effective in deterring legislation that would increase the deficit.

The BEA has been criticized for not going far enough. Indeed, during the years immediately following the 1990 budget agreement, the deficit increased significantly. However, legislation in violation of the BEA did not cause that increase. Rather, it stemmed from worse-than-anticipated economic performance and higher-than-expected health care costs, which drove down revenues under current law and drove up spending under current law. Those are some of the same factors that made relying on fixed deficit targets enforced by sequestration unsustainable and led to the BEA procedures now in effect. What critics really mean is that, in their view, the budget agreements that the BEA helped to carry out were not ambitious enough. The BEA procedures do not force sterner agreements to be forged, although they do not stand in the way of such agreements.

After more than 20 years of experience with the Congressional Budget Act, some tentative conclusions are beginning to emerge. First, the act created an infrastructure for budgeting that has proved to be of lasting value. The institutional capacity and budget planning and enforcement mechanisms put in place under the act, as modified over the years, ensure that the Congress can develop and carry out a coordinated budgetary and fiscal policy plan. Although the current system may not be perfect, the Congress possesses the tools to craft overall budget policies that are in accord with the preferences of a majority. In short, the essential elements for effective budget control by the Congress are in place.

Second, although the budget process provides the means for the Congress to advance its budgetary objectives, the process alone is limited in what it can accomplish. The budget process can provide policymakers with information that relates to the decisions they face. It can permit extensive participation in making those decisions, and it can constrain decisions to prevent some undesired outcomes. However, the process alone cannot substitute for the specific policy decisions necessary to produce a particular outcome. Budgeting has no magical powers: at best, it can provide opportunities for the Congress to make informed decisions and not stand in the way once those decisions have been made.

Third, budget enforcement procedures tend to be more successful when they focus on those things that can be controlled directly. About two-thirds of total spending (so-called mandatory spending) and most revenues flow from permanent laws, which in many cases are adjusted automatically for changes in economic activity and other factors that fluctuate and are difficult to predict. Moreover, mandatory spending--especially for health care--is the fastest growing category of federal expenditure.

The GRH act established fixed deficit targets significantly below baseline levels. But it did so before a political consensus was reached on the changes in laws governing mandatory spending and revenues that were necessary to reach those targets. Thus, it created a conflict between the budget process and current budget policies that forced policymakers to choose between the imperatives of the process and their policy preferences. Policymakers chose initially to revise the fixed targets and then later to abandon them instead of making policy changes of the magnitude required.

The BEA avoided that tension by establishing procedures to enforce specific deficit reduction agreements and to ensure that new budgetary legislation would be consistent with those agreements. It did so by establishing controls on annual appropriations through the discretionary spending limits and on legislation affecting entitlements and taxes through the deficit-neutrality provisions of the act. The

relative success of the BEA stems in part from its confinement to controllable legislative actions. That strength is particularly apparent in the case of discretionary spending.

Nevertheless, the philosophy of deficit control underlying the BEA has certain drawbacks. For example, by focusing only on controlling new legislation, the BEA does not force the Congress to enact measures to change current policies. Entitlements can still expand because of changes in population, inflation, and utilization rates that occur under existing law. However, given the experience with fixed deficit targets, it is unclear whether procedural devices can force policymakers to make changes in policies that are at odds with the preferences of a majority. Also, dividing the budget into separate categories for purposes of budget enforcement may limit certain budgetary options, such as paying for a tax cut with cuts in discretionary spending.

Finally, change in the budget process rarely works out as envisioned and typically carries unintended consequences. For example, the GRH act and the BEA have been criticized for adding excessive complexity to the budget process. Yet they are complex largely because they are intended to improve budget discipline and ensure that the President carries out budget enforcement statutes in line with Congressional intent. Although a simpler, more streamlined budget process may be a worthy goal, it might come at the cost of the budgetary discipline necessary to

reduce the deficit. Thus, in fashioning an effective budget process, it may not be possible or even advisable to accommodate all such worthy goals.

MAJOR CRITICISMS AND SELECTED REFORM PROPOSALS

Although the budget process generally works well, many policymakers find it frustrating and difficult. Over the years, new budget mechanisms and enforcement procedures, such as those added by the Congressional Budget Act of 1974 and the BEA, have been combined with long-standing budgetary practices and traditions in the pursuit of various goals.

Critics maintain that as a result of those and other developments, the budget process has become excessively complex, time-consuming, and rule-bound. They argue further that the Congress seems consumed by its annual action on the budget and has insufficient time to complete its scheduled budgetary actions or to conduct other, equally important legislative business. Critics also contend that despite the seeming excess of budgetary rules and procedures, controls in the budget process for mandatory spending are inadequate. Some also maintain that current budget accounting rules and practices, which date back nearly 30 years, should be updated.

Fewer budget rules, more simplicity, a less crowded budgetary agenda, and other, similar goals for the budget process are certainly desirable, but so are lower deficits. Many of the procedures that are criticized as too complex, such as PAYGO requirements, discretionary spending controls, and accompanying sequestration reports, have also succeeded in controlling the deficit.

Given current efforts to eliminate the deficit, those rules may eventually outlive their usefulness. That time, however, might not come as soon as many people would like, even if the current effort to balance the budget by 2002 is successful. Pressures on the budget that will surface early in the next century with the retirement of the baby-boom generation may make it at least as difficult to reduce the deficit in the future as it is to now.

Several proposals have been offered in recent years to address criticisms of the budget process. I will discuss a few of the major ones.

A Joint Budget Resolution

Some policymakers advocate converting the budget resolution to a joint budget resolution that must be enacted into law. They point to last year as an example of the need for this reform. It is better, they say, to use the budget resolution as a vehicle

to force the President and the Congress to reach broad agreement early in the year to promote more timely action on subsequent budget legislation and avoid conflicts over individual spending and revenue measures.

It is unclear whether agreement between the President and Congress on budgetary matters will be more forthcoming if the budget resolution becomes the formal vehicle for its implementation. However, such a change would probably alter the fundamental purpose of the budget resolution as a means for the Congress to establish its own budget priorities. Last year, because the Congress did not have to wait for the President to begin its budget process, it could make significant progress on annual appropriation measures and other bills.

Harder to gauge is whether momentum toward political agreement with the President may have been created as the Congress proceeded with its own budget process. Would the President have modified his budget proposal last year in the same way without the steady drumbeat of budgetary legislation coming from the Congress? Did the legislative momentum created last year by the budget resolution and other legislation move the President closer to the Congress's position, even if ultimate agreement still has not been reached?

Biennial Budgeting

Some people believe that biennial budgeting would relieve part of the budgetary pressure on policymakers. Under biennial budgeting, some or all of the annual budget cycle would be converted to a two-year cycle, with budget resolutions, appropriation bills, authorization measures, and other budgetary legislation (or some combination of those measures) considered only every other year.

The impact of biennial budgeting would probably vary depending on the types of measures to which it was applied. Some proposals would convert the budget resolution to a two-year cycle and make it a joint resolution. In that case, the Congress and the President would have to weigh the consequences of setting overall budget policy only every other year. Less frequent review of the budget could lead to missed opportunities. Because budget projections and estimates can change dramatically in relatively short periods, reviewing budget policies annually can be helpful, even if those policies cover multiyear periods. Also, until the long-range deficit picture improves, it may be advisable to revisit budget policies more rather than less frequently.

Biennial budgeting might have its greatest impact on the annual appropriation process. Proponents of biennial appropriations contend that appropriating every other year would have payoffs in improved planning for federal agencies and more

time for Congressional oversight. Opponents are concerned that biennial appropriations might diminish the effectiveness of Congressional control of spending and simply necessitate supplemental appropriations or other adjustments in the off-year.

A Cap on Mandatory Spending

The deficit will probably not be brought under control without significantly reducing the rate of growth in mandatory spending--principally for Medicare and Medicaid. Consequently, control of mandatory spending represents one of the greatest challenges facing the budget process. With the baby-boom generation's retirement beginning only 15 years from now, dealing with growth in entitlements will become even more critical.

In late 1991, it began to be apparent that unanticipated mandatory spending increases under current law would erode much of the savings from the 1990 budget agreement. As a result, proposals surfaced for some type of cap on mandatory spending similar to the limits on discretionary spending that had proved so successful under the BEA.

However, mandatory spending caps are likely to suffer from the same problem that affected fixed deficit targets under the GRH act. They establish spending targets for entitlement programs that are at odds in some cases with the underlying law for those programs. At some point, a conflict is created between the requirements of the process and the underlying program in which reductions must be made. Furthermore, in the case of entitlement law, the process requirements may also conflict with legal commitments that are enforceable by the courts. Spending limits for appropriations work because the spending is not encumbered by such problems and is generally provided anew each year.

If mandatory caps were enforced by sequestration, a further problem would be that spending for Medicare and Medicaid--two of the largest and fastest growing entitlement programs--outpaces spending for most other entitlements. Large increases in those health care entitlements could trigger massive reductions in other programs, even though spending for those other programs may be relatively more controlled.

Budget Accounting Rules

Some policymakers advocate changing current budget accounting rules for certain kinds of activities. They maintain, in part, that the cash basis used for recording most

federal expenditures does not accurately reflect the costs of certain programs. In response to such concerns, the Federal Credit Reform Act of 1990 changed the accounting treatment of federal credit programs from a cash basis to a measure of the estimated subsidy cost.

One oft-cited proposal would create a capital budget, under which procedures would be established to account for spending on public investment in a different manner than spending on current consumption. The budget process does not distinguish between spending on investments that provide benefits over a number of years and spending on current consumption. Modifying the budget process so that it would make such a distinction might be a useful step. However, depending on its design, a capital budget could lead to a serious loss of budget discipline, particularly if what is considered an investment becomes too broad. With the current focus on long-term economic growth, it is important to differentiate government consumption from public investment, but redefining the budget process to meet that need could be risky.

CONCLUSION

Because the present budget process works relatively well does not mean that it is without flaws or that it should not be reevaluated when circumstances change. BEA

procedures, including the discretionary spending limits, PAYGO requirement, and associated Congressional enforcement procedures, expire at the end of fiscal year 1998. Clearly, given the success of the BEA, its enforcement regimen should be continued as long as deficit reduction remains a priority.

However, although the budget process now successfully controls new spending and tax actions under BEA procedures, other problems remain. For example, projected increases in existing mandatory spending programs by and large continue to drive future deficits. Moreover, beyond the current budgetary horizon loom the potential deficits associated with the retirement of the baby-boom generation. By the middle of the next century, the deficits suggested by that demographic trend (if current policies continue) will easily dwarf any deficit experienced or projected to date. The relatively limited future view of the current budget process does not promote action on those potential longer-term deficits. However, there is no procedural device for controlling mandatory spending or dealing with long-term deficits that would substitute for direct changes in programs themselves.

In any event, the basic purposes and limitations of the budget process should be kept in mind as part of any review or reevaluation of it. The budget process generally is intended to allow a consensus to work its will in setting budget policy. Over the years, its has performed that task admirably. When it has been modified to

force policy changes without an underlying consensus on those changes, it has failed. Much of the evidence of the apparent failure in the budget process actually reflects disagreements over budget policy. The budget process cannot force a consensus on budget policy when one does not exist, and it should not be modified to try to do so.