CENTER ON BUDGET AND POLICY PRIORITIES

820 First Street, NE, Suite 510, Washington, DC 20002
Tel: 202-408-1080 Fax: 202-408-1056 center@cbpp.org http://www.cbpp.org

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HOW TO AVOID OVER-COMMITTING THE AVAILABLE SURPLUS: WOULD A TAX-CUT "TRIGGER" BE EFFECTIVE OR IS THERE A BETTER WAY?

by Richard Kogan

Summary and Overview

The Congressional Budget Office projects large surpluses over the next ten years — $2.7 trillion excluding Social Security and Medicare. CBO says, however, that "the longer term outlook is unusually hard to discern at present. ... CBO's projections, like those of other forecasters, are based on just a few years' increased growth of productivity... projections of those recent changes as far as five or 10 years into the future are bound to be highly uncertain." Data CBO has provided suggest that even if Congress enacts *no* tax cuts and *no* spending increases over the next decade, there is a 35 percent chance the ten-year surpluses outside of Social Security and Medicare will be only half as big as projected and a 20 percent chance there will be no surpluses.[1]

In addition to the risk that current budget projections may be too optimistic, there is the risk that other, currently unforeseen circumstances will arise during the coming decade that increase budgetary pressure, such as faster-than-expected increases in health care costs or the possible emergence of a foreign military threat. Furthermore, even if the current projections prove precisely accurate, the projected surpluses are known to be temporary because the baby boom generation will start retiring before the end of this decade, ultimately leading to substantial increases in the cost of major federal programs such as Social Security, Medicare, and Medicaid. While projected surpluses may or may not materialize in the coming decade, long-term budgetary pressures that will arise when the baby boomers retire are more certain.

> ***"Such enormous uncertainty about budgets just a few years in the future should influence policymakers' decisions about expensive, long-term commitments on the basis of mere projections."*** OMB, *FY 2002 Economic Outlook, Highlights from FY 1994 to FY 2001, FY 2002 Baseline Projections*, January 16, 2001, p. 26

[1] For a discussion of the degree of uncertainty surrounding CBO's projections, see *Surplus or Deficit? Projections of a Large Budget Surplus Are Surrounded by a High Degree of Uncertainty*, Richard Kogan, Center on Budget and Policy Priorities, Feb. 6, 2001. Also see Chapter 5 of *The Budget and Economic Outlook: Fiscal Years 2002-2011*, CBO, January 31, 2001.

Because of the great uncertainty in the projections, policy-makers could find that tax cuts or program increases enacted this year produce deficits outside Social Security and Medicare, rather than surpluses, an undesirable result given the need to increase national saving in preparation for the baby boomers' retirement. This paper examines and compares two strategies for minimizing the risk that enacting tax cuts or program increases will produce future deficits. (For ease of discussion, this paper uses the terms "surplus" and "deficit" to refer to the surplus or deficit in the federal budget excluding Social Security and Medicare Hospital Insurance (HI), except when the paper explicitly discusses the unified budget.)

- A "***trigger,***" under which legislation cutting taxes or increasing mandatory programs also would include a statutory mechanism that automatically delays some or all of those tax cuts or program increases if the current budget projections turn out to have been too optimistic and deficits result.[2]

- A "***budget reserve***," under which this session of Congress would enact tax cuts or program increases that use up some *but not all* of the projected surpluses. To the extent that current projections hold true and surpluses materialize in later years, Congress could enact additional tax cuts or program increases in those years.

This paper concludes that a budget reserve would be much simpler than a trigger and far more likely to be effective in preventing a return to deficits. It is quite likely that a trigger will be evaded or will save far less than may be needed to avert deficits. Because of this likelihood, a trigger could lull policymakers into concluding incorrectly that a large tax cut that includes a trigger entails little or no risk of a return to deficits. Such a conclusion could lead to a bigger tax cut than would be enacted in the absence of a trigger, and therefore a *greater* risk of a return to deficits if, as is probable, the trigger proves largely ineffective for the reasons described below.

A Trigger

A trigger approach was tried under the old Gramm-Rudman-Hollings (GRH) law, under which automatic spending cuts were supposed to be triggered if the budget headed off a predetermined track and missed specific deficit targets set forth in the statute.[3] GRH failed,

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[2] A trigger based on a specified level of debt rather than a specified surplus or balanced budget is discussed in the text box on pages 5 and 6. This analysis concludes that whether the target is a specified level of the surplus or a specified level of the debt makes little difference in the operation of the trigger. For simplicity, this paper assumes that the event that would trigger a delay in enacted tax cuts or mandatory benefit increases would be a deficit outside of the Social Security and Medicare Hospital Insurance trust funds. This approach is consistent with a budget plan that would use the entire $2.7 trillion surplus on tax cuts, program increases, and attendant increases in interest costs. Alternatively, a budget plan might choose to use only part of the projected $2.7 trillion surplus for those purposes, in which case the plan would call for surpluses during the period 2002-2011. Under such a budget plan, the event triggering a delay in enacted tax cuts or mandatory benefit increases could be a surplus smaller than that called for in the budget plan.

[3] Gramm-Rudman-Hollings refers to the Balanced Budget and Emergency Deficit Control Act of 1985 (P.L. 99-177 and its successor, P.L. 100-119).

A Trigger vs. A Reserve:
What Rudman and Rubin Say

On March 12, the Concord Coalition held a press briefing in which two former Treasury Secretaries (Pete Petersen and Robert Rubin), two former Senators (Warren Rudman and Sam Nunn), and Paul Volcker, former Chairman of the Federal Reserve, warned of the dangers of over-committing the projected surplus. Questioned about tax-cut triggers, Rudman and Rubin both argued that trigger would likely be ineffective and a reserve would be superior.

Senator Rudman remarked, "I probably have more experience with triggers than anyone in the room. We had a trigger in Gramm-Rudman, as some of you may recall. ... I can tell you from my experience that it's easy to mess around with triggers because people can fuss around with the numbers [or] they can ignore them. I mean, there was no criminal penalty for not pulling the trigger. If you didn't pull the trigger, the members of the Budget Committee weren't carted off to the federal penitentiary, so there was no forcing mechanism.

"A better thought, in my mind, rather than a trigger would be to ... put a more moderate tax cut in place over the next several years, and then ... if these surpluses pile up, [there is] no reason not to renew it and expand it. That would make a great deal of sense. It's certainly less risky.

"My sense is if you were to do that, [and] if there [subsequently] were problems in the economy, you can probably live with a more moderate tax cut. If you put the whole tax cut into place and the problems develop, you would have a serious problem. So... a better way [than a trigger] would be to have a rolling tax cut that was at a lower level..."

Secretary Rubin added, "A trigger sounds good conceptually. I think once you get into the practicalities of it, it seems to me there's a pretty good probability it's not going to work. Therefore, I agree with Warren, you start with a moderate tax cut, and two, three, four years down the road, if the projections materialize, you can decide what to do."

however, to produce anything close to the budget results the GRH statute ostensibly required; the intentions of the GRH law were thwarted by widespread evasions and gimmicks that characterized its brief career and prevented its trigger mechanism from working as intended. The failure of GRH illuminates the practical realities that a trigger tied to a tax cut would likely encounter. Any trigger mechanism, no matter how well designed, is likely to suffer from most or all of the following five problems:

- If the trigger depends on whether the budget for the coming fiscal year is projected to be in surplus or deficit, the Office of Management and Budget can use a rosy forecast to produce the desired projection of a budget surplus, thereby insuring that the tax cuts continue in full force. The Supreme Court has ruled that automatic, triggered changes in law must be based on estimates made by Executive Branch officials, so any trigger that is based on budget projections will put OMB and the White House in charge, rather than more politically neutral officials at CBO or the General Accounting Office.

- If the trigger is based on *actual* budget results — such as whether the budget for the prior fiscal year ended up in surplus or in deficit — Congress can readily make last-minute shifts in the timing of billions of dollars in federal payments. Such timing shifts may suffice to restore a surplus for the about-to-be-completed fiscal year even though they would do nothing to restore fiscal health. For decades, Congress has been adept at inventing timing shifts; recently, more than $11 billion in expenditures were first shifted by statute from 2000 into 2001 to make the 2000 budget look better, and then shifted back from 2001 to 2000 to make the 2001 budget look better.

- The trigger may be politically unsustainable. No matter how technically sound a trigger mechanism is, Congress may be unable to resist the public pressure to deliver "promised" tax cuts or program benefits. The public may never understand (or may forget) that the promised tax cuts (or benefit expansions) were supposed to be contingent upon the accuracy of the surplus projections.

- Even without rosy forecasts, legislated timing shifts, or political interference, a trigger mechanism is unlikely to work well.

  One risk is that a trigger will save considerably less than is needed. For instance, although the tax cuts proposed by President Bush are phased in over a number of years, the vast majority are fully in effect by 2006. Yet most of the projected surplus occurs after 2006, and it is the projections for these later years that are the most uncertain. If these projections prove to be incorrect and deficits were to return after 2006, the trigger would provide almost no remedy because it would be too late to delay most of the enacted tax cuts; the tax cuts would already have been phased in fully by this time.

  There are additional problems with a trigger that is based on observed deficits in the just-completed fiscal year. Such a trigger could fail to delay tax cuts because no deficit was observed in the just-completed year, even when the budget was evidently sliding toward a major problem. Or the trigger could delay tax cuts even when the observed deficit was just a one-year aberration and did not signal a continuing budget problem. If the one-year aberration was the result of a temporary economic slowdown, then automatically delaying the tax cut might be the wrong fiscal medicine, possibly making a recession more likely, deeper, or longer.

- A trigger is likely to have unintended consequences, since the numerous new budget rules that would have to be implemented to enforce the trigger could end up affecting the balance of power between the institutions setting budget and economic policy. For example, the Executive Branch was able to manipulate parts of the GRH law to further its policy goals and reduce Congressional influence. Because OMB estimates were used to measure the size of the

Does Tying the Trigger to Debt Levels Rather Than Surplus Levels Solve These Problems?

Under any trigger, Congress must meet a specified budget target to avoid automatically delaying tax cuts (or mandatory program increases). Three possible types of budget target are:

- a specified surplus or a balanced budget excluding Social Security and Medicare Hospital Insurance;
- a specified surplus including Social Security and Medicare Hospital Insurance;
- a specified level of the debt held by the public.

The type of budget target chosen in a trigger makes almost no difference to this analysis. If Congress is required to meet a budget target based on OMB projections, OMB can create rosy scenarios to project the target will be met. This is true whether the target is for a specified level of surplus or for a specified level of publicly held debt. Likewise, if Congress is required to meet a target based on actual outcomes (such as the *actual* surplus or publicly held debt at the end of the just completed fiscal year), shifting the timing of billions of dollars in outlays or receipts a few days may suffice to avoid pulling the trigger. If a target cannot be evaded by optimistic forecasting or timing shifts, political pressure might induce Congress to abandon the trigger mechanism and allow the full tax cut or mandatory program increase to take place as scheduled. Even if a target is not evaded through rosy scenarios or timing shifts and is not abandoned because of political pressure, the trigger mechanism — delaying those aspects of a tax cut or mandatory increase *not yet phased in* — will likely save far less than needed to meet the target.

All these aspects of this analysis are equally applicable whether the budget target is the surplus excluding Social Security and Medicare, the surplus including those trust funds, or the debt held by the public.

Other aspects of the analysis may be affected to a modest degree by the type of target Congress chooses. The nature of gimmicks such as altered scorekeeping might differ slightly depending on the type of target. The unintended consequences also might differ.

Altered Scorekeeping. One simple way to evade a target tied to a specified level of the surplus is to declare by statute that a certain type of federal spending does not count against the target. This expedient will not help evade a target based on the debt held by the public, since it will not change the amount the Treasury has to borrow. On the other hand, there are other ways in which scorekeeping can be altered to evade a target for the debt. For instance, Congress could mandate that the term "debt held by the public" be limited to Treasury debt, i.e. that it exclude debt instruments issued by other agencies. About $28 billion in federal debt that currently is outstanding consist of debt was issued by agencies other than the Treasury, such as through FHA debentures and TVA bonds. If Congress acted to exclude agency debt from the debt target, it would achieve an immediate $28 billion windfall and would likely induce more federal borrowing to be undertaken by agencies and less by the Treasury. (This would increase the government's interest costs since markets demand higher yields on agency securities.)

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More obliquely, *disguised* agency borrowing can be expanded and can be redefined as not constituting agency debt. Disguised borrowing occurs when agencies issue lease-purchase contracts, monetary credits, or other binding promises as a way of financing government activities, rather than simply paying cash up front. Currently, CBO and OMB attempt to see through such disguises and classify such transactions as “outlays financed by borrowing,” but Congress or the administration could alter the scorekeeping so that such gimmicks would no longer “count” against the debt. Proposals for disguised borrowing were common during the Gramm-Rudman-Hollings era.

Unintended Consequences. For simplicity, this analysis has been written as though the goal is to avoid a deficit outside of Social Security and Medicare. If, instead, the goal is to hit a specified target for the debt, budget transactions involving Social Security and Medicare Hospital Insurance will become part of the calculation. One result would be that legislation to cut Social Security or Medicare benefits, or legislation to increase payroll taxes, would help meet the targets.

Another result is that loan guarantee programs would gain a favored position relative to direct loan programs. Currently, outlays for direct loan and loan guarantee programs are both calculated based upon the estimated subsidy they provide to a borrower. If the subsidy and administrative costs are essentially the same (as with direct student loans and guaranteed student loans), there is little budgetary reason to prefer one method of providing benefits over another. But although federal outlays and the surplus are the same whether direct loans or loan guarantees are chosen, the debt is not. With direct loans, higher federal debt occurs up front as the loans are made and lower debt occurs later when they are repaid; with loan guarantees, the same net cost does not show up until years later, when default claims are paid. Converting from direct loans to loan guarantees would make it easier to meet near-term debt targets even though such a conversion may have no effect on the surplus or on the government’s long-term financial position. In essence, this would be another timing gimmick.

A third result is that the Treasury might be pressured to change its cash management strategies to avoid triggering a delay in tax cuts. Although the debt generally declines by the amount of the unified budget surplus, the relationship is not exact. One reason for this is that the Treasury keeps tens of billions of cash in banks, earning interest, rather than redeeming debt. The cash is needed to cover the difference between daily outlays and receipts, which are not fully predictable. If the Treasury finds itself close to the debt target at the end of the year, it may be under great pressure to run down its cash balances to an unusually low level (posing some risk of delays in payment on government checks) or to sell gold or foreign currency to avoid issuing debt securities (or to allow faster redemption of debt securities). Such cash management distortions would be another form of timing gimmick. They also could be costly if gold or foreign currency were sold at less than optimum prices.

"problem" that had to be addressed to avoid triggering across-the-board spending cuts, the Administration was able to set the parameters of the budget debate. The Administration could, for example, propose a series of cuts in discretionary programs and then define the scope of the "problem" as being similar to the amount of savings the proposed cuts would produce. Under a new trigger tied to tax-cut legislation, Congress could be placed in the position of having to chose between delaying tax cuts or acquiescing to Administration pressure to cut various domestic programs (and being blamed for blocking the scheduled tax cut if it did not approve the budget cuts).

To avoid triggering off a tax cut, Congress might even feel compelled to grant emergency power to the President to impound funds or delay expenditures. Alternatively, Congress could enact across-the-board cuts to annual appropriations bills, even if the fiscal problem that threatened to delay the next phase of a tax cut was caused by the surplus projections being overly optimistic (and the tax cut consequently having been made too large in the first place) or by the tax cut having unanticipated side-effects that resulted in its costing more than was anticipated. When it comes to last-minute budget cuts, appropriations bills often are the only available target.

If Congress were to cut the appropriations bills for a given year to avoid triggering off the next phase of a scheduled tax cut, however, that also would pose another problem. It would be making *one-year* budget cuts to enable a *permanent* tax cut to take effect.

Finally, a trigger could interact with the Federal Reserve's operation of monetary policy. When the Fed raises interest rates to stave off inflation, the normal result is an increase in federal interest costs, i.e., an increase in federal expenditures. Would it be appropriate for such an increase to trigger a delay in a tax cut? Would it be appropriate for such an automatic result to influence the Fed's decisions on monetary policy?

A Budget Reserve

The case for a budget reserve was made recently by former Treasury Secretary Robert Rubin. In a *New York Times* opinion editorial, Rubin wrote, "[I]t is wise to be prudent — we should avoid committing ourselves to dramatic courses of action that are hard to reverse... even if you favor a very large tax cut as the preferred use for [the] available surplus — which I emphatically do not — even a moderate degree of prudence would suggest waiting a few years to see whether or not the projected surpluses are actually occurring..."[4]

[4] *A Prosperity Easy to Destroy*, New York Times op-ed, Sunday, Feb. 11, 2001.

A budget reserve does not suffer from the five defects of a trigger, as outlined above. A reserve merely requires that tax cuts or program increases be enacted partly in this year and partly in other, future years, rather than all at once; Congress can continue enacting tax cuts or program increases in future years so long as current projections prove to be valid and the surpluses actually materialize.

History suggests it is far easier to enact additional tax cuts and budget increases in coming years if the projections hold up or improve than to enact tax increases or budget cuts in future years if the projections prove to have been too optimistic.

It is difficult for Congress to repeal tax cuts or mandatory program increases once they have been enacted. And for the reasons discussed here, it is unlikely a trigger would succeed in delaying tax cuts or mandatory program increases if a need to do so arose. In contrast, it entails much less political and budgetary risk to enact more prudent tax cuts or program increases this year, and then to enlarge them to the extent that future surpluses materialize. Holding some of the currently projected surpluses in reserve is both simpler and likely to be more effective than a statutory trigger in minimizing the risk of a return to deficits.

How Big is the Projected Surplus and How Reliable are the Projections?

On January 31, CBO released its latest budget projections. The projections show a surplus in the current year, fiscal year 2001, and in each of the subsequent ten years from 2002 to 2011. Those ten-year surpluses (outside Social Security and Medicare) total $2.7 trillion. More than 70 percent of these projected surpluses occur in the second five years, 2007-2011. Partly for that reason, CBO's projections are especially uncertain. CBO devoted a chapter of its recent report on the budget to the uncertainty surrounding its projections, in which it wrote:

> The longer term outlook is also unusually hard to discern at present. ... CBO's projections, like those of other forecasters, are based on very limited information about just a few year's increased growth of productivity and strong investment in information technology. Projections of those recent changes as far as five or 10 years into the future are bound to be highly uncertain. ... Looking forward five or 10 years ... increases the likelihood that budgetary decisions will be made on the basis of projections that later turn out to have been far wrong.[5]

Other authorities agree with CBO. For instance, OMB recently wrote, "Over the history of five year budget projections, ... every administration has made substantial errors." Alan Greenspan, Chairman of the Federal Reserve, recently testified that "These impressive upward revisions [to projected long-term growth rates] are based on inferences drawn from economic

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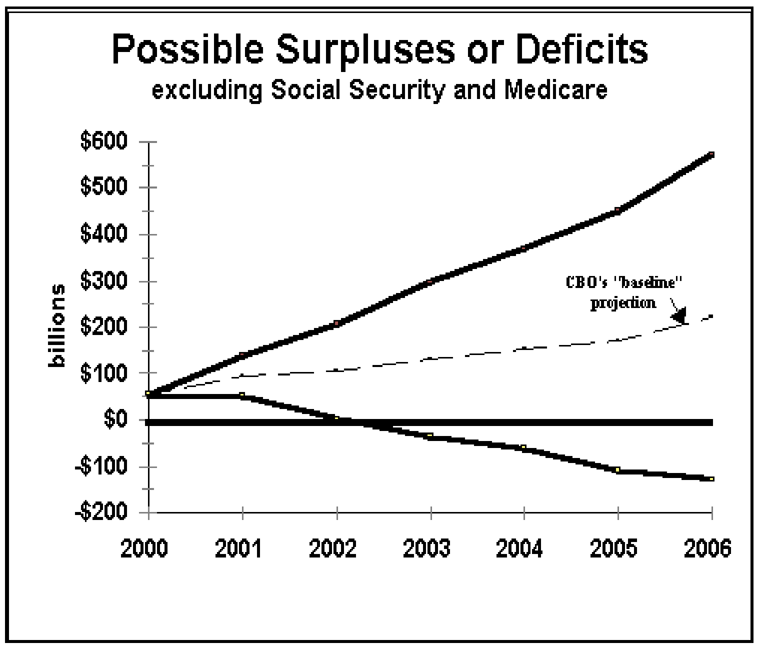
[5] CBO, op. cit. (Footnote 1)

relationships that are different from anything we have considered in recent decades. The resulting budget projections, therefore, are necessarily subject to a relatively wide range of error."[6] In addition, Rudy Penner, a former director of CBO, wrote "The most important thing about [CBO's] errors is that they are often very large. ... It is somewhat disturbing ... that small errors are, so far, less likely than large errors."[7]

In its recent report, CBO employed three methods to quantify the degree to which it was uncertain about its projections. First, based on its own historical track record, CBO calculated the average error of its previous projections. If CBO's projection for 2006 (the fifth year in its current ten-year forecast) turns out to be off by the average amount (as a percentage of GDP) that its previous budget projections for the fifth year were off the mark, the budget in 2006 could end up — without any tax cuts or spending increases — with anything from a surplus of $573 billion to a *deficit* of $127 billion.



The dashed line in the middle of the graph represents CBO's projected surpluses for the period 2001 through 2006. The projected surpluses start at $56 billion for 2000, the fiscal year just completed, and grow to $223 billion by 2006. The heavy lines above and below the dashed line represent two possible alternative results, one if surpluses are *greater* than projected by the amount of CBO's average error in the past and the other if surpluses are *smaller* than projected by the amount of CBO's average error. The lower line shows that, starting in 2002, there may not be any surpluses, even with no tax cuts or spending increases.

The same CBO analysis suggests there is about a 20 percent chance that, with no tax cuts or spending increases, the budget will be in *deficit* each year from 2002 through 2006, and a 35 percent chance the surpluses will be only half as great as CBO projects.

The CBO report also includes alternative ten-year projections that CBO has produced, based on alternative assumptions about economic growth, the proportion of national income that

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6 Testimony before the Committee on the Budget, U.S. Senate, January 25, 2001.

7 *Errors in Budget Forecasting*, Rudy Penner, Urban Institute, 2001 (unpublished manuscript).

is subject to taxation, and medical costs. CBO's "pessimistic" scenario turns its ten-year surplus projection of $2.7 trillion outside Social Security and Medicare into a ten-year deficit projection of $600 billion. CBO commented that "[i]f CBO's track record is any guide, both the optimistic and the pessimistic scenarios lie well within the range of uncertainty in the budget projections."[8] In short, each of CBO's methods of quantifying uncertainty shows that the current surplus projections might turn out to be off target by wide margins and that there might be little if any surpluses at all.

In addition to the uncertainty of the economic forecast and the resulting budget projections, there is a considerable degree of *policy* uncertainty inherent in any forecast. CBO does not attempt to project changes in the public's preferred tax and budget policies — it attempts to project the costs of continuing current laws and policies unchanged. But one can imagine external events that will almost force Congress to react in significant ways. One geo-political question is whether China will emerge as a friend or a powerful enemy over the next decade or so. Russia, too, could revert to militaristic antagonism or evolve toward stability and international co-operation. Alternatively, other international threats could arise.

Similarly, health care costs could climb more rapidly than is currently projected, and there is always a chance the United States could be hit with a major and costly epidemic. Likewise, there is a chance, for example, of major damage on the West Coast from a powerful earthquake or in the Southeast from a major hurricane.

In addition, there are other known and virtually certain-to-be-satisfied claims on the projected $2.7 trillion surplus that, if recognized in budget forecasts, would make the surplus projections smaller and more realistic. For example, CBO's projection methodology assumes that certain tax preferences — such as the Research and Experimentation Tax Credit — that are renewed every two years or so on a short-term basis will expire, even though Congress has invariably extended these highly popular credits in the past. Likewise, CBO does not assume that assistance to farmers provided one year at a time (rather than under a permanent law) will continue, even though it has averaged about $10 billion per year for the last three years and has strong bipartisan support. The current CBO projection also includes almost nothing for natural disasters and foreign military operations, even though in the recent past these have averaged about $9 billion per year. Finally, CBO does not adjust for increases in the U.S. population when it projects funding levels for appropriated programs; as a result, the CBO projection assumes that the real goods and services these programs provide will be cut back on a per-person basis. Adjusting for these factors provides a more realistic estimate, which is that the available surplus is about $2.0 trillion, rather than $2.7 trillion, over the ten-year period from 2002 to 2011. Moreover, given the uncertainties in the budget projections, it would be imprudent for policymakers to commit this entire $2.0 trillion, since some of it may not materialize.

The conclusion of Chairman Greenspan's recent, much-remarked-upon testimony before the Senate Budget Committee addresses this issue and merits particular attention:

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[8] CBO, op. cit.

> Only if the probability was very low that prospective tax cuts or new outlay initiatives would send the on-budget accounts into deficit, would unconditional initiatives appear prudent. ... Faced with these uncertainties, it is crucial that we develop budgetary strategies that deal with any disappointments that could occur ... it is not difficult to imagine the hard-earned fiscal restraint developed in recent years rapidly dissipating. We need to resist those policies that could readily resurrect the deficits of the past and the fiscal imbalances that followed in their wake.[9]

Chairman Greenspan's warning against "unconditional initiatives," including unconditional tax cuts, may be based on his concerns about the political difficulties that would ensue if the budget picture in the future turns out less rosy than is currently forecast. After all, while CBO strives to make estimates that are as likely to be too pessimistic as too optimistic, the risks for policy makers are not symmetrical. It will not be very difficult to enact additional tax cuts or program increases in coming years if the CBO estimates prove to have been too pessimistic; it will be much harder to enact tax increases or program cuts in coming years if the estimates prove to have been overly optimistic.

Two Alternative Approaches: a Trigger and a Budget Reserve

Because of his concern with "unconditional initiatives" and "in recognition of the uncertainties in the economic and budget outlook," Chairman Greenspan suggested that "it is important that any long-term tax plan, or spending initiative for that matter, be phased in. Conceivably, [any long-term tax plan] could include provisions that, in some way, would limit surplus reducing actions if specified targets for the budget surplus and federal debt were not satisfied."[10] His words have prompted discussion of attaching a "trigger" of some type to whatever tax cut Congress enacts this session. The trigger would be intended to scale back the tax cut automatically under certain circumstances specified in law.

A budget reserve is an alternative to a trigger. Under a budget reserve approach, Congress would enact smaller tax cuts (and smaller spending increases) this year than it ultimately desires; the remainder of the projected surplus would be set to the side as a deliberate reserve or hedge against the possibility that the budget projections may

What Chairman Greenspan Said

"In recognition of the uncertainties in the economic and budget outlook, it is important that any long-term tax plan, or spending initiative for that matter, be phased in. Conceivably, [any long-term tax plan] could include provisions that, in some way, would limit surplus reducing actions if specified targets for the budget surplus and federal debt were not satisfied."

[9] Greenspan, op. cit.

[10] Greenspan, *op. cit.*

be too optimistic. If the projections ultimately prove valid, further tax cuts or program initiatives could be enacted in future years as the surpluses materialize. History suggests it is far easier to enact additional tax cuts and budget increases in coming years if the projections hold up or improve than to enact tax increases or budget cuts if the projections prove to have been too optimistic.

One particular approach to establishing a budget reserve was spelled out recently by Robert Reischauer, President of the Urban Institute and former director of CBO, in an op-ed in the *New York Times*.[11] The Reischauer proposal is discussed below.

How A Trigger Would Work

A first question in designing a trigger is what the circumstances are that would trigger an automatic reduction in tax cuts. There are two main possibilities:

Projected Deficits: Under this approach, tax cuts would be scaled back when OMB projects deficits for the current fiscal year, or alternatively for the coming fiscal year.

Observed Deficits: Under this approach, tax cuts would be scaled back when the Treasury reports that the just completed fiscal year has closed with a deficit.

A second basic question is *how* a trigger would scale back enacted tax cuts? While there are many possibilities, only one — a "triggered delay" — has been seriously discussed on Capitol Hill. Under this approach, if a deficit is projected or observed (depending on the design of the trigger), aspects of a phased-in tax cut *that have not yet taken effect* would be delayed one year. For example, assume an enacted tax-rate reduction were phased in over five years. Assume further that, after two years, a deficit occurs in the fiscal year just completed or is projected to occur in future years. With an observed or projected deficit, the trigger would delay implementation of the remaining three phases of the rate reduction. Implementation would remain suspended until the deficit problem had been addressed or gone away on its own.

A Budget Reserve

A budget reserve is straightforward to describe and implement; it is a hedge against uncertainty in CBO's projections. In this year's budget resolution, Congress would call for tax cuts and program initiatives that do *not* consume the entire projected, realistically available surplus in 2002 or any future year. The amount of the projected surplus that is not consumed would be placed in a reserve as a hedge or rainy day fund against the significant possibility that the projections are overly optimistic. To the extent the projected surpluses materialize, Congress could enact additional tax cuts or program expansions in future years.

[11] New York Times, Thursday, February 8, 2001.

There are many ways to turn this simple concept into a specific budget framework. In his op-ed in the *New York Times*, Robert Reischauer described one such approach:

> Even if the budget projections were solid, it would be myopic to commit our entire surplus today. ... New [rules] should limit the ability of Congress and the president to tie up future surpluses, especially those that are more than five years away. ... With these rules, Congress would be free to cut taxes and boost spending — but not too wildly. If all goes as projected, there should be some money left for tomorrow's lawmakers to use for new priorities and unforseen emergencies. And if surplus projections prove to be overly optimistic, the country would be saved from painful economic choices.[12]

Reischauer suggested that specified portions of the surplus be set aside or held in reserve. This year's budget resolution (Congress's annual planning document for all the budget actions that Congressional committees will take this year) would set aside, or hold in reserve, 20 percent of the surplus that CBO currently projects for 2002 and 2003, 30 percent of the surplus CBO currently projects for 2004 and 2005, and so on, with 60 percent of the surplus projected for 2010 and 2011 — the final two years of the 10-year period — being set to the side. The percentage of the projected surpluses that would be set aside would rise as one looks further ahead because CBO's projections become increasingly uncertain the further one looks into the future.

Under Reischauer's formulation, each Congress would be allowed to use the remaining percentages of the surplus. These percentage would be applied each year to what was then the current CBO surplus projection. Future CBO projections might show surpluses that are bigger or smaller than the surpluses that CBO projects today. The budget reserve consequently would constitute a hedge against downward reestimates. At the same time, additional tax cuts or program increases would be allowed in future years if this year's projection turned out to be accurate or to have understated the surplus.

Over the ten-year period, Congress could eventually use 97 percent of CBO's currently projected surplus, or $2.6 trillion, under the Reischauer formula *if* the current CBO projections proved accurate. If the surpluses turn out to be smaller than those currently projected, smaller amounts could be used.

If Congress were to implement a budget reserve in this year's budget resolution, it could set the concept of a reserve in place for subsequent years through either new congressional rules or a statutory mechanism. If Congress is attracted to the Reischauer proposal, for example, this year's budget resolution could set revenue and spending targets under which the percentages of the projected surplus that Reischauer specifies would remain unused. This year's budget resolution or some other vehicle also would amend the rules of the House of Representatives and the Senate to specify the percentage of future, remaining surpluses that future budget resolutions would be allowed to commit. Reischauer goes further and suggests enactment of a statute

[12] Reischauer, op. cit.

modeled on the Budget Enforcement Act of 1990 and enforced through sequestration to prevent this or future Congresses from committing more that the specified percentages of surpluses that are currently projected or will be projected in the future.

While Reischauer's budget reserve proposal comes with specific percentages and enforcement mechanisms, a more elementary type of reserve also can be constructed. A reserve could simply entail a basic decision to consume less than the entire surplus now, and consume the rest in future years if and when the budget projections firm up and the projected surpluses materialize. This could involve erecting rules preventing the part of the surplus that is to be set to the side from being used for tax cuts or program increases.

Because the uncertainty surrounding CBO's budget projection is so large, neither a trigger nor a budget reserve can *guarantee* the existence of future surpluses. But because a trigger is unlikely to work as intended and may not work at all, a budget reserve is likely to do a much better job of minimizing the risk of budget deficits.

A Trigger Would Raise Complex Issues, be Subject to Manipulation and Evasions, and Could be Counterproductive

A trigger mechanism would likely suffer from several weaknesses. The experience that the nation had in the last half of the 1980s with the Gramm-Rudman-Hollings (GRH) law, which also contained a trigger, illustrates these weaknesses.

In GRH, fixed deficit targets were set in statute. If those targets were not met, an unpleasant change in law — across-the-board budget cuts — was supposed to be triggered automatically; almost all annual appropriations and selected entitlements were supposed to be cut back. A trigger attached to a tax-cut bill this year would operate in a somewhat similar manner — the remaining phases of the tax cut would be delayed automatically if a specified budget target, such as budget balance outside Social Security and Medicare, was not met.

The Gramm-Rudman-Hollings law proved ineffective. Its trigger mechanism did not work. GRH failed for five reasons, all of which also could undermine a tax-cut trigger.

First, under GRH, both the administration and Congress adopted deliberately optimistic projections to meet, on paper, the budget targets that determined whether the GRH trigger would be pulled. Second, both the administration and Congress engaged in budget gimmickry — especially timing shifts — to create the appearance of meeting the budget targets. Third, when the budget targets became too onerous to live with and too difficult to meet through evasions, the GRH targets were first raised and eventually abandoned. Fourth, the economy proved to be more powerful than the budget, and attempts to force the budget to hit fixed targets ultimately did not work when the economy shifted in unforeseen ways. Fifth, the GRH law required the development of dozens of pages of obscure budget rules regarding accounting, budget implementation, and other apparently technical issues. These rules produced unintended consequences for budget policy and institutional arrangements. These and other problems, which could recur if a tax-cut trigger were enacted, are discussed below.

Enactment of a trigger could leave policy-makers, the media, and the public with the comforting but mistaken impression that voting for large tax cuts involves less risk of a return to deficits than is the case. Such an impression could lead to a bigger and less fiscally prudent tax cut than would be enacted in the absence of a trigger. Since a trigger is unlikely to work as intended, the presence of a trigger may, paradoxically, lead to less rather than more fiscal responsibility.

Problem #1: Rosy Scenarios

A trigger could be designed to delay tax cuts or program increases if a deficit is projected for the fiscal year that starts on the coming October 1. GRH similarly required that statutory deficit targets for the coming fiscal year be met. If the statutory targets for that year would not be met, automatic budget cuts were supposed to occur shortly after the start of the fiscal year in an amount sufficient to erase the projected "excess deficit."[13]

In 1986, the Supreme Court ruled that since an automatic budget cut constituted a change in law (it reduced the amount of spending that would otherwise occur), Congress could delegate the authority to estimate whether the statutory deficit target had been met only to the President or an Executive Branch official, not to CBO or GAO.[14] As a result, authority over the estimates was lodged in OMB. The same would be true of any new tax-cut trigger: OMB (meaning the White House) would have sole authority to determine if the target for continuing to phase in the tax cut had been met.

Soon after the GRH law was enacted, it became apparent that OMB would adopt rosy scenarios to show on paper that the president's budget plan met the GRH requirements and to reduce or eliminate the need for Congress to raise taxes or cut spending to deal with deficits. In January 1989, for instance, OMB estimated that the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Insurance Corporation (FSLIC) would spend less than $1 billion in fiscal 1990 to deal with the raging crisis in the savings and loan industry. At the

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13 In principle, the purpose of any trigger is to scale back tax cuts or program increases if it appears the budget is heading off track in some fundamental way, e.g., if more updated projections show the original permanent tax cut or program increase will no longer fit within the projected multi-year surpluses. Logically, it should be less important that the near-term figures are off track by a little than that the projected multi-year figures are off track by a large amount. But if a trigger is designed to be based on the total amount of a five-year or ten-year projection, for instance, it will be even easier for OMB to adopt a rosy economic forecast that guarantees the tax cuts will stay in place.

14 See *Bowsher v Synar*, 1986. That decision invalidated the initial GRH law because the ultimate authority over the budget estimates that produced sequestration was delegated to the Comptroller General, whom the Supreme Court considers a Legislative Branch official.

same time, CBO estimated those agencies would spend $10 billion in fiscal 1990. (Actual spending on deposit insurance that year far exceeded both the OMB and the CBO forecasts.)

One result of perennial rosy scenarios during the GRH era was that with each passing year, the government tended to miss the deficit targets that the GRH law had established by a larger amount (see table below). Another result was that the OMB projections were increasingly ignored by Congress, the media, and the public; they were assumed to be biased. CBO ultimately concluded that "Rosy scenarios are almost inevitable in any system that focuses on meeting fixed deficit targets."[15]

Amount by which actual deficits exceeded the statutory targets established by the first and second GRH laws.[16]
(in billions of 2001 dollars)

Fiscal year	First GRH law	Second GRH law
1986	79	
1987	9	
1988	71	17
1989	115	24
1990	253	166
1991	350	267

Under any new trigger mechanism, CBO would, once again, have an advisory role at best. Enforcement of a trigger that prohibits a deficit in the coming fiscal year would rest with

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15 *The Economic and Budget Outlook: Fiscal Years 1994-1998,* CBO, January 1993, p. 89.

16 The first GRH law was held unconstitutional in 1986 because the Comptroller General, a Legislative Branch official, was ultimately responsible for the budget estimates that determined how it operated. The second GRH law superseded the first and became effective with fiscal 1998. It set more relaxed deficit targets, but those targets as well were exceeded by large and growing amounts. The 1991 targets were repealed after the date on which the "final" automatic spending cuts for fiscal year 1991 were supposed to have gone into effect.

GRH appears to have been least ineffective in fiscal 1987, but this is a mirage. To begin with, there was no GRH law in effect that year because the first GRH had been overturned by the Supreme Court and the second GRH law had not yet been enacted. Second, the relatively better budget outcome in fiscal 1987 was caused primarily by a sudden, one-time influx of revenues resulting from timing aspects of the 1986 tax reform act. That act was independent of any GRH considerations and was intended to be revenue neutral.

OMB, and the administration then in office could direct OMB to produce rosy scenarios to prevent a trigger that would delay tax cuts from being pulled.

Problem #2: Timing Shifts and Altered Scorekeeping

The experience with rosy scenarios may lead some to suggest that triggers be based on *actual* budget results — if the fiscal year ends with a surplus, all well and good; if not, the tax cuts or program increases must be scaled back.

Such an approach, however, is itself subject to budget gimmickry. There are two main classes of budget gimmicks: timing shifts and altered scorekeeping.

Because the Treasury keeps track of the federal government's cash flow on a day-by-day basis, Congress can have a good sense of the likely surplus or deficit as we approach September 30, the last day of the fiscal year. Suppose that in late September, the daily Treasury statements indicate a likely deficit of $5 billion. Under normal circumstances, the Treasury disburses about $24 billion during the last five days of the fiscal year. Congress can direct the Treasury to delay selected expenditures for a few days, so they will be disbursed at the beginning of the next fiscal year instead of the end of the current fiscal year. The result is that the current deficit disappears and the tax cuts do not have to be delayed. Thus, even a trigger based on *actual* budget results can be evaded through last-minute timing shifts.

Even though timing shifts are fairly blatant, they are fairly common. For example, in the summer of 1999, Congress delayed payments for military contractors, armed forces personnel, and many federal civilian personnel by a few days (from fiscal 2000 into fiscal 2001) to make the fiscal 2000 budget look more than $5 billion better. Then, in the summer of 2000, Congress repealed those timing shifts before they had taken effect, shifting the expenditures back into fiscal 2000. This time, the effect was to make the fiscal 2001 budget (which had by then become the center of attention) look $5 billion better.

Sometimes timing shifts are better disguised. For example, Virginia Governor James Gilmore's proposal to sell Virginia's future tobacco settlement receipts for current cash simply shifts the timing of government receipts from the future to the present. The federal government engaged in a similar gimmick in 1989, when the Resolution Finance Corporation (REFCORP) was established to raise cash on behalf of the Federal Savings and Loan Insurance Corporation (FSLIC) during the savings and loan crisis; the cash would be repaid later with interest. Each of these timing shifts is really just a hidden form of government borrowing.

Timing shifts produce no real savings. The use of timing shifts could, however, allow a trigger to be evaded and the next stage of a permanent tax cut to take effect.

The other major gimmick is altered scorekeeping, in which Congress writes into statute the way in which a certain transaction is to be scored for official budget purposes or the Administration makes a unilateral change in scorekeeping. Declaring an expenditure "off

“Triggering Off” vs “Triggering On”: a Distinction Without a Difference

In recent discussions of possible tax cut “triggers,” some have claimed a distinction between a mechanism that would “trigger off” tax cuts under adverse circumstances and one that would “trigger on” tax cuts if circumstances are not adverse. As a matter of law and logic, there is no substantive difference between the proposals — the distinction lies only in the way the mechanism is explained to the public and how the public may respond to it.

Imagine, for example, that Congress wants the next stage of a phased-in tax cut to go into effect only if the budget is in surplus in the just-completed fiscal year. This can be explained as “triggering on” a tax cut. The statute may contain a provision saying, “If, in the fiscal year completed on Sept. 30, the Treasury reports that the budget of the United States is in balance or surplus excluding the Old-Age, Survivors, and Disability Trust Funds and the Hospital Insurance Trust Fund, then the tax cuts described in sections ___, ___, ____, and ___ of this Act shall become effective the next following January 1.”

But the same provision of law can be explained as “triggering off” a tax cut, since the next stage of a phased-in tax cut will *not* go into effect if there is a deficit. As can be seen, allowing a tax cut to phase in when there is a surplus is identical to preventing a tax cut from phasing in when there is a deficit.

budget" is one way to do that; although the expenditure does in fact occur, it no longer counts. In 1981, for example, in an effort to make President Reagan’s first budget appear to produce a unified budget surplus by fiscal 1984, OMB Director David Stockman agreed to a congressional proposal to declare the purchase of oil for the Strategic Petroleum Reserve "off budget" on the grounds that this was just the exchange of one liquid asset, cash, for another liquid asset, oil. Oil purchases for the strategic petroleum reserve were then returned to on-budget status in 1985.

In 1993, CBO published an assessment of GRH and the Budget Enforcement Act of 1990. CBO concluded that in many cases, "the legal requirement to meet the [GRH] targets was satisfied by using overly optimistic economic assumptions and outright budget gimmickry, such as shifting military pay dates between years and moving costly spending off budget."[17] Because a tax-cut trigger, like GRH, would require adherence to a fixed budget target set in law — most likely a requirement that the budget exclusive of Social Security and Medicare Hospital Insurance be balanced — we can reasonably expect the same results as occurred in the GRH era.

Problem #3: Sustaining a Trigger

One question is whether Congress will simply repeal or override a trigger mechanism if it becomes onerous or presents politically unpalatable choices. As shown in the table on page 16, the GRH deficit targets became increasingly hard to hit. When Congress enacted the second

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[17] CBO, op. cit., p. 87.

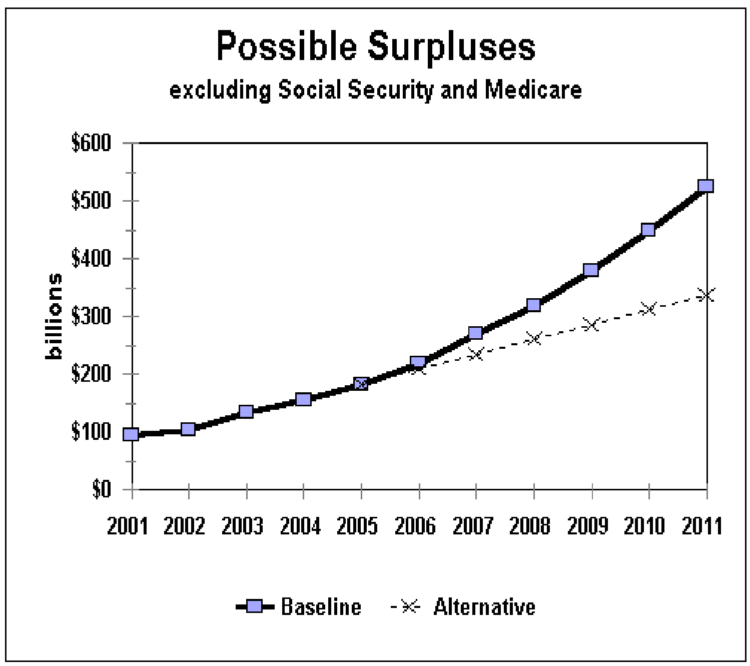
GRH law in 1987, it deliberately eased the deficit targets it set in the first GRH law in 1985, but even these eased targets were missed by increasingly large amounts.

By 1990, it became clear that neither rosy scenarios nor gimmicks would allow Congress to *appear* to meet the GRH deficit targets. Furthermore, it became politically untenable either to allow the huge automatic across-the-board budget cuts that GRH was supposed to trigger to occur, or to enact enough tax increases and budget cuts to meet the fiscal 1991 deficit target and thereby avoid the automatic budget cuts. Congress solved this problem by, in effect, repealing GRH and replacing it with the Budget Enforcement Act of 1990, which differed from GRH precisely in that it did *not* have an automatic trigger mechanism that attempted to correct for overly optimistic estimates.

The history of GRH suggests that swings in the economy are too powerful for Congress or a trigger mechanism to counteract fully and that if compliance with a tax-cut trigger mechanism tied to a fixed target for the deficit or surplus became too onerous, Congress would change the target or repeal the mechanism.

Problem #4: Too Little, Too Late *or* Too Much, Too Soon

Even if Congress and the Administration avoided rosy scenarios and used no budget gimmicks, the trigger would be unlikely to work as intended for other reasons. There are three issues here: the amount of savings that a trigger would produce could be much smaller than the amount needed to maintain budget balance; a trigger mechanism could tip a weak economy into recession; and a trigger mechanism could trigger off tax cuts when there is no real need to do so or fail to trigger off tax cuts when there is a need for such action.



Too Little, Too Late: It is quite possible that deficits could begin to reemerge in 2006. The upper line in the graph on this page shows CBO's projected surplus. As the graph indicates, CBO projects the surplus will start to grow more rapidly beginning in 2006. Suppose that from 2006 on, the surplus grows at the same rate it is projected to grow from 2001 through 2005, rather than accelerating as CBO *currently* projects. This scenario is shown by the lower, dotted line in the graph. Now imagine that tax cuts and program initiatives enacted this year use all of the surplus that CBO currently projects, so that balanced budgets would result in all years through 2011 *if* CBO's projection proves precisely accurate. In such a case, if the lower, dotted line turns out to be the more accurate projection, deficits will start to appear in 2006 and grow in each successive year. (These deficits are represented by the distance between the upper line and the lower line in the graph.) The deficits would equal $35 billion in 2007 and total $510 billion over the five-year period from 2007 to 2011.

How would a trigger work in such a circumstance? Starting in 2007, a trigger would delay those stages of the tax cut that had not been phased in yet. Under President Bush's tax proposal, however, almost all of the tax cuts except estate tax repeal would be phased in fully by 2006. A trigger that took effect starting in 2007 could save only about $9 billion in that year and approximately $65 billion over the five-year period from 2007 to 2011, including debt service, by postponing indefinitely the remaining stages of estate tax repeal. In this scenario, the trigger would restore only $65 billion over five years, even though the size of the budget problem could equal $510 billion over this period.

The amount a trigger would save thus can fall far short of the amount needed to get back on track, even if the trigger works as intended and is not evaded through rosy scenarios or budget gimmicks.

Too Much, Too Soon: The second way a trigger might produce inappropriate results, even if it were allowed to function as designed, is if tax cuts were delayed because a temporary downturn in the economy caused a temporary return of deficits. Such a downturn might occur at some point in the next decade and might produce a deficit, even if the underlying budget path remained on track with CBO's current projection. An economic downturn could produce a temporary deficit because income tax revenues decline in downturns, because corporate profits and therefore corporate income taxes are quite sensitive to relatively small fluctuations in the economy, and because the cost of programs such as unemployment compensation and food stamps responds noticeably to economic fluctuations. Economists consider these developments to be "automatic stabilizers" because they quickly and automatically pump money into a slowing economy through reductions in tax collections and increases in government expenditures, thereby stimulating the economy when it is sliding. (Likewise, they automatically restrain an economy threatening to go into an inflationary boom.)

In the circumstances just described, a delay in a tax cut is not really needed because the budgetary problem is temporary. In fact, automatically scaling back the tax cut in such a case may be unwise economic policy.

Random Noise: The third problem with a trigger is that it might produce "false positives" or "false negatives." Sometimes revenues bounce up or down $10 billion or even $20 billion in a given year for no discernable reason, or for unexpected and non-recurring reasons such as a major court case or legal settlement, an unexpected decision of some companies to write off losses, or sudden changes in the exchange rate. While a one-time bounce of $10 billion or $20 billion may not have meaning, it may be enough to trigger a delay of the tax cut when there is no underlying need to do so.

More importantly, such a budget bounce in the other direction might temporarily disguise the fact that the projections are turning sour, and delay for a year the operation of the trigger. But a one-year delay in the operation of the trigger would allow another stage of the phased-in tax cuts to take effect permanently. The result would be that a meaningless, one-time bounce in revenues would result in a permanent tax cut. This is as inappropriate as if a rosy scenario or budget gimmick resulted in a permanent tax cut.

Problem #5: Unintended Consequences of The Trigger

A trigger mechanism may have other unintended consequences. Here are two types of possible unintended effects.

Shifts in Power from Congress to the President. History suggests that OMB can arrange budget estimates to create a "problem" that furthers the administration's objectives. Suppose the President's budget includes $10 billion or so in budget cuts that could encounter difficulty on Capitol Hill. OMB might announce that unless a shortfall of an amount such as $8 billion is eliminated, the

A Presidential Waiver?

A suggestion has been made that any trigger include a provision allowing the President to waive its requirements if, in his judgment, a delay in the tax cut would harm the economy. As this analysis notes, pulling a trigger and delaying tax cuts if a target is missed because of an economic slowdown could constitute unwise policy.

Nonetheless, the principal conclusion of this analysis is that a trigger mechanism is likely to be ineffective because triggers can be evaded through use of rosy scenarios, timing shifts, or other budget gimmicks. A presidential waiver would make it even easier for an administration to evade a trigger. A waiver provision would create a loophole even larger than the mechanisms that can already be exploited to disarm a trigger — the president could simply decide the trigger should not take effect.

The current administration claims its proposed tax cut will help the economy in the short run. It also invokes supply-side arguments to claim its tax cut will boost the economy in the long run. Given these beliefs, if the Administration had this waiver authority, it might always find that a triggered delay in the tax cut would adversely affect the economy and might never allow a trigger to be pulled. Such a viewpoint might be shared by a subsequent administration, as well.

In short, the proposed waiver would represent an attempt to respond to one of the lesser problems of a trigger (its potential impact during an economic downturn) by making its most serious shortcoming — the fact that it would likely prove ineffective as a result of policymakers' ability to maneuver around it — even more problematic.

tax-cut trigger will be pulled. An $8 billion amount would be large enough to be meaningful but probably not so large that Congress would simply override the trigger. Congress would then find itself having to choose between allowing a scheduled tax cut to be delayed or making $8 billion in spending cuts, most likely in domestic programs. The White House could threaten to blame Members of Congress of the opposite party for preventing a scheduled tax cut from taking place if they opposed the Administration's budget cuts. An analogous situation occurred several times in the GRH era.

Moreover, if the trigger depends on avoiding actual deficits, and if OMB's January estimate of the current fiscal year shows a small deficit, the Administration may have enhanced power to induce Congress to enact a rescission bill or to grant the president unilateral authority to make deferrals or rescissions. Under such a scenario, the alternatives available to Congress would be risky: it could do nothing and hope OMB's estimate of a deficit proved too pessimistic; it could try to prepare the public for the likelihood that promised tax cuts would not occur (in hopes that it would not be blamed too harshly by the public for causing the tax-cut delay by failing to enact the President's spending cuts); or it could wait until September, when the fiscal year was 11/12 over, and try to shift expenditures from the current year into the next year.

The choice of cutting annual appropriations or granting rescission or deferral authority to the President also would mean, in essence, that defense or domestic appropriations would suffer for the errors of others. In this case, the errors could be that the budget projections turned out to have been overly optimistic or that the tax cuts Congress enacted are losing more revenues than expected. During the GRH era, Congress made last-minute appropriations cuts on several occasions to avoid violating the GRH deficit targets even though the Appropriations Committees had remained within their budget allocations.

In short, the White House would be strengthened if it used its ability to trigger delays in the tax cuts as a way to force Congress to take budget actions that Congress otherwise did not wish to take. Within Congress, the appropriations process could be subject to increased pressure because appropriations bills are always considered late in the fiscal year and because it is easier to design ways to cut appropriations than to cut entitlements or raise taxes.

Further, if appropriations are cut to avoid triggering a delay in a tax cut, the result is that Congress will have made a temporary reduction in funding for appropriated programs to allow a permanent reduction in revenues to occur. As with rosy scenarios or budget gimmicks, such a result weakens long-term fiscal discipline.

Interactions with Monetary Policy. The Federal Reserve endeavors to stabilize the economy and achieve optimum growth with low unemployment by managing the growth of the money supply and through that, managing market interest rates. There are times when the Fed believes it must raise interest rates to curb inflation.

When the Fed raises interest rates, there usually is an increase in the federal costs of interest on the federal debt either a few months or a year down the road. What if those higher interest costs sufficed to throw the budget into deficit and therefore trigger an automatic delay in tax cuts? Should the Fed allow such a possibility to influence its decisions on monetary policy? If not, is it appropriate for tax cuts to be scaled back as an unintended consequence of the Fed's role in restraining inflation?

Conclusion

This analysis suggests a trigger may be ineffective in meeting its stated goal. A trigger can be evaded by rosy scenarios or budget gimmicks and can be overridden by political pressures for tax cuts. Even at its best, a trigger is unlikely to save enough to make up for errors in budget projections. In addition, a trigger may constitute inappropriate fiscal policy during temporary economic slowdowns and also may interfere with monetary policy.

Enactment of a trigger might reassure some that it is safe to vote for a large tax cut or mandatory program increase even in the face of considerable uncertainty about CBO's budget projections. If so, the trigger could lead to the enactment of a larger tax cut or program increase than what would have been enacted in the absence of a trigger. Some policy-makers may be willing to gamble that upward reestimates will cover the larger costs. They may be willing to risk automatic delays in the size of the tax cuts, in return for getting more of their preferred tax cuts into the code. Given the evidence suggesting that a trigger is unlikely to work very effectively, the presence of a trigger could ultimately lead to larger revenue losses or program increases and less debt reduction than would occur in the absence of a trigger. If so, a trigger designed to enhance fiscal responsibility will have the opposite effect.

The budget reserve, in contrast, is a more direct and sure-footed way to minimize the risk that budget projections will prove too optimistic. It sets aside a portion of the currently projected surplus as a hedge against uncertainty. It allows tax cuts or program increases to be enacted this year, and also in the future if the projections prove accurate and the surpluses materialize. It minimizes political fallout from erroneous projections. It does not create incentives for Congress or the Administration to resort to rosy projections or to revert to budget gimmickry. And it leaves resources available that Congress could use later, if it wishes, for such purposes as facilitating legislation to reform and restore long-term solvency to Social Security or Medicare.