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
www.cbpp.org

November 18, 2010

CHANGING BUDGET PROCESS WON'T REDUCE DEFICIT — ONLY SPECIFIC POLICY CHANGES CAN DO THAT

Peterson-Pew Commission Proposals Are Seriously Flawed

by Paul N. Van de Water

A commission funded by the Peter G. Peterson Foundation and the Pew Charitable Trusts has proposed far-reaching changes in the process by which the President and Congress develop and implement the federal budget.[1] The commission argues that the current federal budget process contributes to large deficits and that reducing the deficit requires overhauling the budget process. It recommends a series of short-term and longer-term process changes, including statutory debt targets and spending limits that would be enforced through automatic spending cuts and tax increases.

Attempting to make Congress enact deficit-reduction measures by establishing fixed budget targets enforced by automatic cutbacks was tried in the 1980s and didn't work then. There is no reason to believe that this approach will succeed in the future.

Moreover, if the process that the commission recommends did work, it could exacerbate economic recessions and make recovering from them even more difficult. Debating changes in the budget process could also let lawmakers continue to avoid the real work of reducing long-run deficits by making specific policy changes that raise revenues and reduce spending. The commission is to be commended, however, for recognizing that both tax increases and spending cuts will be necessary to stem the projected growth of federal debt.

The Commission's Proposals

The Peterson-Pew commission divides its recommendations into two main parts: measures to be implemented immediately and those to be put in place after the federal debt is stabilized.

The initial measures would aim to stabilize the federal debt at 60 percent of the gross domestic product (GDP), or some other level, by 2018. The commission proposes enacting annual debt targets that would "set a reasonable path to achieve this medium-term fiscal target." Both the President's annual budget submission and the annual Congressional budget resolution would be required to

---

[1] Peterson-Pew Commission on Budget Reform, *Getting Back in the Black,* Committee for a Responsible Federal Budget, November 2010, http://budgetreform.org/sites/default/files/Getting_Back_in_the_Black.pdf.

comply with the prescribed annual debt targets. Enacted budget legislation would be enforced through caps on discretionary spending and a modified pay-as-you-go process for mandatory spending and taxes. Failure to achieve the statutory debt targets would trigger automatic tax increases and across-the-board spending cuts, with the required adjustments limited to 1 percent of GDP in any year.

The longer-term provisions would be put in place after the medium-term debt target is reached. At that point, the commission proposes the enactment of new targets that would gradually lower the debt as a share of GDP. The commission calls for the enactment of "policy changes to deal with longer-term drivers of the debt," which it identifies as health care spending, Social Security, and tax expenditures. Once these policy changes are adopted, says the commission, "budgetary triggers should be attached to the programs to cap their growth at the budgeted amounts."

In addition to these changes in the budget process, the Peterson-Pew Commission proposes a number of changes in how the federal budget is presented and how certain costs are measured and accounted for. Notably, it recommends that budget presentations should highlight the amount by which the components of the budget will change in nominal terms, compared to levels in the current year, without any adjustment for inflation, population growth, or changes in the size of the economy. As explained below, this proposal could make deficit reduction agreements harder, rather than easier, to achieve.

Debating Budget Process Is a Distraction

The budget process changes recommended by the Peterson-Pew Commission do not address the real budget issue. Stemming the long-run growth of federal debt requires increasing revenues and reducing spending. It's that simple — and that difficult. Legislators find it very hard to agree on which revenues, if any, should be raised and which spending should be cut. To make matters worse, some of them advocate large permanent tax cuts that will exacerbate the long-run budget problem.

The state of the economy further complicates the situation. Reducing deficits in the short term could stall the fragile recovery. Policymakers should therefore tolerate large deficits for several years in order to maintain strong aggregate demand until more progress is made in reducing unemployment and getting the economy back on its feet. But it would be advisable for them to act sooner rather than later to enact a deficit-reduction package, while delaying the effective date of many of its provisions until the economy is in much better shape.[2]

Debating changes in the budget process now would let lawmakers continue to avoid the real work of raising revenues and cutting spending, while requiring them to consider many of the same difficult issues. For example, the Peterson-Pew Commission proposes that annual short-term debt targets be enforced through automatic tax increases and spending cuts, with a 50-50 split between the two.[3] Reaching agreement on what debt targets to establish and how to set up the automatic deficit-reduction mechanism would be little easier than enacting a package of specific tax and spending

---

[2] Kathy Ruffing, Kris Cox, and James Horney, *The Right Target: Stabilize the Federal Debt,* Center on Budget and Policy Priorities, January 12, 2010.

[3] The commission says (p. 15) that "credit [would be] given for policies enacted that year on either side of the budget," but it does not explain how this would work.

changes. Enacting automatic tax increases, for example, would generate just as much controversy as other questions of tax policy. And as long as the focus was on process rather than substance, Members of Congress could continue to deflect responsibility for their inability to make tough budgetary choices. The likely result would be more delay. Moreover, if policymakers could enact debt targets, it is unlikely that doing so would actually produce meaningful deficit reduction, since policymakers could subsequently seek to maneuver around the targets, waive them, or raise them. That is what happened after Congress set deficit targets in the Gramm-Rudman-Hollings laws of the mid-1980s.

Fixed Debt or Deficit Targets Would Be Ineffective at Best, Harmful at Worst

Previous attempts to compel policymakers to make substantive budget choices by threatening painful automatic cuts if they failed to meet certain targets have not achieved major deficit reduction, and enacting fixed debt targets is likely to prove a similarly ineffective means of reducing the budget deficit. However, if the proposed process did work, it could inflict harm on the economy.

Fixed Targets and Automatic Cuts Would be Ineffective. The Peterson-Pew Commission proposal for fixed targets enforced by automatic triggers has been tried before. The 1985 and 1987 Gramm-Rudman laws set annual deficit targets, with the aim of achieving a balanced budget, and imposed automatic spending cuts if the targets were expected to be missed. Debt targets (as proposed by Peterson-Pew) and deficit targets (as contained in Gramm-Rudman) are arithmetically equivalent, since the increase in debt held by the public in the course of a year equals the annual budget deficit plus "other means of financing." In most years, other means of financing are relatively small.

Congress repealed Gramm-Rudman in 1990 because it failed.[4] When big automatic cuts loomed, the Reagan and Bush Administrations used rosy budget estimates to make the shortfall "disappear" on paper or to reduce the size of the required cuts. Then the Administration and Congress either enacted gimmicks — such as asset sales, timing shifts in program spending, and moving entities "off budget" — to address much of the remaining shortfall or they raised the deficit target.

The Peterson-Pew Commission contends that "[p]ast automatic triggers have failed in part because so many programs were exempt from the trigger." It therefore recommends that the "proposed triggers apply to the broadest base possible, including all discretionary and mandatory programs and all taxes."[5] While the commission deserves credit for proposing automatic tax increases alongside automatic spending cuts, the historical record suggests that the scope of the automatic mechanism is not critical to its success or failure and is not the reason the Gramm-Rudman law was regularly evaded.

The Budget Enforcement Act (BEA) of 1990 replaced the fixed deficit targets of Gramm-Rudman with a process designed to enforce compliance with the deficit-reduction measures agreed to at the 1990 budget summit. The BEA established caps on discretionary spending and a pay-as-you-go requirement that legislation affecting mandatory spending or revenues not add to the deficit. These

---

[4] See Henry Aaron and others, *A Balanced Approach to Restoring Fiscal Responsibility,* July 2008, and the references cited therein, http://www.cbpp.org/files/7-9-08bud.pdf.

[5] Peterson-Pew Commission, p. 15.

procedures were back-stopped by automatic spending cuts that applied *to precisely the same programs* specified in the Gramm-Rudman law, but unlike Gramm-Rudman, the BEA proved successful. Based on this experience, former Congressional Budget Office Director Robert Reischauer concluded that "budget procedures are much better at enforcing deficit reduction agreements (as the BEA has) than at forcing such agreements to be reached (as Gramm-Rudman attempted to do)."[6] Lawmakers were intent on avoiding the automatic cuts, and no one suggested that the threat could be ignored because the scope of programs subject to reduction was too narrow.

The commission's conclusion about the need to increase the scope of automatic cutbacks may be based on a misunderstanding of the historical record. The commission asserts (on page 17 of its report) that the pay-as-you-go legislation enacted in February 2010 (Public Law 111-139) "greatly expands the mandatory programs and activities that are exempt from reduction" under the automatic process. This statement is not correct. The recent legislation adds to the exempt list only a few low-income and economic recovery programs *that did not exist* when the list was previously updated. Otherwise, the programs exempt from automatic cuts under the 2010 pay-as-you-go law and those exempt under the successful Budget Enforcement Act procedures are essentially identical.

Fixed Targets Could Harm the Economy. If they were actually adhered to, fixed debt or deficit targets could harm the economy, since they would require additional tax increases or spending cuts *just when the economy was at its weakest*. When unemployment rises and incomes stagnate in a recession, the federal budget responds automatically: tax collections shrink, and spending goes up for programs like unemployment insurance, Social Security, and Food Stamps. The current economic downturn, for example, has added $400 billion or more to the actual or projected budget deficit in 2009, 2010, and 2011.[7] If fixed debt targets were in place, Congress would have to offset the effects of these "automatic stabilizers" by raising taxes or cutting spending during or just after a recession. Meeting the debt-to-GDP target would also become more difficult during and after a recession because the denominator of the fraction, GDP, would grow less rapidly. Finally, the debt target would preclude Congress from enacting additional measures, such as temporary tax cuts or extended unemployment insurance benefits, to spur the economy.

Recognizing this problem, the commission says that the debt targets should "be flexible enough to accommodate changes in economic conditions. For example, the requirements to meet the annual target could be waived when there is a marked deterioration in the economy, as signaled by two consecutive quarters of negative real growth or another similar measure."[8] Such an exception, however, would be far from sufficient to deal with the problem. In the recent recession, positive economic growth resumed in the third quarter of 2009, but the economy remains weak, and the economic downturn continues to add significant amounts to the budget deficit.[9] If the commission's proposal had already been in effect, it could have required deep budget cuts in fiscal year 2010 and the current fiscal year, which would have made the recovery considerably more anemic and unemployment substantially higher than it already is.

---

[6] Robert D. Reischauer, Director, Congressional Budget Office, Statement before the Subcommittee on Legislation and National Security, Committee on Government Operations, U.S. House of Representatives, May 13, 1993.

[7] Kathy Ruffing and James R. Horney, *Critics Still Wrong on What's Driving Deficits in Coming Years,* Center on Budget and Policy Priorities, June 28, 2010, p. 8, http://www.cbpp.org/files/12-16-09bud.pdf.

[8] Peterson-Pew Commission, p. 10.

[9] Ruffing and Horney, *Critics Still Wrong.*

The need for legislation to revise the targets would also make the task of economic stabilization even more challenging than it already is. The commission notes that "Congress and the President could also revisit and update the annual [debt] targets because of unanticipated changes in economic and other technical factors." But a change would require 60 votes in the Senate and could easily take months to enact, if it were enacted at all. If the targets were not changed, adhering to the targets could make an incipient recession deeper and more protracted and weaken the subsequent recovery.

Enacting Discretionary Spending Caps in Isolation Could Make Deficit Reduction More Difficult. The Peterson-Pew Commission's report appears to recommend that multi-year caps on discretionary spending be enacted at the same time as the debt targets and *before* agreement is reached on specific policies for reducing mandatory spending and raising taxes. Such a move would be extremely unwise. In order to enact a package of deficit-reduction measures that is balanced between discretionary spending, mandatory spending, and taxes, all parts of the budget need to be on the table at the same time. If cuts were made first in discretionary spending, it would be much more difficult to reach agreement about the remaining areas, since any subsequent deficit-reduction proposal would appear over-weighted toward tax increases or reductions in mandatory programs. Had the discretionary caps enacted as part of the 1990 bipartisan deficit reduction agreement been enacted on their own in 1989, the 1990 agreement likely never would have been reached, and deficits would have been higher as a consequence.

Capping Social Security and Health Spending Would Be Problematic

Recognizing that automatic budget procedures are more effective at *enforcing deficit-reduction agreements* than at *forcing deficit reduction itself*, the Peterson-Pew Commission proposes putting caps on Social Security, health care spending, and tax expenditures *after* policy changes have been adopted to put the federal budget on a sustainable long-run course. This aspect of the commission's proposal deserves emphasis. The commission does *not* recommend that spending caps be imposed as a way of prompting major policy changes.

Nonetheless, the commission's proposal raises serious concern. If spending for a program such as Social Security were limited to specified amounts, cuts could be required even if the agreed-upon long-term policies were faithfully followed. For example, an unexpected increase in the Social Security disability and retirement rolls during and after a recession would require cutting Social Security benefits. In contrast, the discretionary spending caps and pay-as-you-go rule under the BEA required automatic cuts only when Congressional action added to the deficit.

The proposed long-term caps on Social Security, health care spending, and tax expenditures would be enforced by automatic adjustment procedures, but the commission does not suggest the form that such automatic adjustments should take. In fact, the commission explicitly notes that "long-term triggers can be designed in a number of ways." These design details would matter greatly in evaluating a specific proposal, although imposing fixed limits on Social Security spending would be undesirable under any circumstances.

Capping Social Security Would Be Misguided. Capping spending for Social Security would represent a fundamental change in the nature of the program. From its beginning, Social Security has paid guaranteed benefits to everyone who qualifies by making payroll tax contributions. The program

provides retired and disabled workers with a benefit that equals a predictable fraction of their former earnings. Once a person starts receiving benefits, those benefits are adjusted to keep pace with increases in the cost of living. In contrast, under the Peterson-Pew proposal, Social Security spending would be required to fit within fixed dollar amounts. No longer could people be sure of what their monthly benefits would be. As a result, Social Security would become considerably less effective in protecting older Americans, persons with disabilities, and survivors of deceased workers from economic insecurity.

Capping Social Security spending is also unnecessary. Some unexpected changes — for example, an increase in inflation — increase *both* Social Security benefits *and* Social Security revenues by similar amounts and have little effect on Social Security's annual surplus or deficit. Other changes — such as higher real wage growth — will increase Social Security benefits but increase revenues by even more and *reduce* the annual deficit. In neither case would there be any justification for cutting Social Security benefits. Yet under the commission's proposal, that apparently is what would occur. Moreover, even if Social Security's annual deficit exceeded projections in some year, it would still not be necessary to make an automatic cut in benefits, since the self-financing nature of the program already guarantees that its spending cannot exceed its income over the long run and that any shortfall will eventually have to be closed through tax increases or benefit reductions.

Medicare Spending and Health Insurance Subsidies Are Already Limited. The new health reform law (the Affordable Care Act, or ACA) establishes an Independent Payment Advisory Board (IPAB) that will develop and submit proposals to slow the growth of Medicare spending if the projected growth in Medicare spending per beneficiary exceeds a specified level. The board's recommendations will go into effect *automatically* unless both houses of Congress pass, and the President signs, legislation to modify or overturn them. The trigger is carefully crafted to avoid requiring cuts that will be politically infeasible or seriously harm Medicare beneficiaries. In 2018 and later years, the law directs the IPAB to limit the growth of Medicare spending per beneficiary to the *rate of growth of gross domestic product (GDP) per capita plus one percentage point*.[10]

The ACA also limits the federal cost of the refundable tax credits that will be provided to help low- and moderate-income people afford to purchase health insurance coverage in the new state-based health insurance exchanges. After 2018, the tax credit for someone at a given income level will be constrained to grow no faster than consumer prices, even though health care costs are expected to grow more rapidly.[11] As a result, with each passing year, modest-income beneficiaries will have to pay a larger share of their income for health insurance premiums.

These targets are sufficiently stringent that some observers have questioned whether they can be achieved, or whether they can be achieved without seriously impairing the access of Medicare beneficiaries to doctors and hospitals and making health insurance unaffordable to many people of limited means. In light of these concerns, it would not be prudent to count on additional budgetary savings from imposing even tighter limits on federal health spending, unless the growth in private health spending can also be slowed. Capping the tax exclusion for employer-sponsored health insurance would help to slow the growth of private health spending somewhat, but the commission's proposal is much more heavily weighted toward reductions in federal health spending.

---

[10] *Patient Protection and Affordable Care Act* (Public Law 111-148), as amended, section 3403.

[11] *Affordable Care Act*, section 1401.

Targeting *federal* health spending without similarly controlling *private* health spending would harm those who are the most vulnerable. Growth in health care costs is *not* driven by factors that are unique to Medicare and other federal health programs. To the contrary, for 30 years, per-beneficiary spending in Medicare and Medicaid has grown at rates nearly identical to those for the overall health care system. Attempting to force substantial cuts in federal health spending without requiring comparable measures to restrain the growth of health costs system-wide would likely disadvantage the poor, the elderly, and people with serious disabilities.

Budget Presentation

The Peterson-Pew Commission recommends a number of changes in budget presentation and accounting. Most of these recommendations are likely to have little practical effect, but one of them would make it more difficult to reduce budget deficits.

At present, budget presentations typically compare future spending and revenue levels with those in the budget baseline — a projection of the amounts of spending and revenues that would result from a continuation of current budgetary policies. The baseline represents a neutral benchmark against which to measure alternative tax or spending policies. Instead, the commission recommends that budget documents should begin with a display of projected changes in spending and revenues from current-year nominal dollar levels — with no adjustment for inflation, population growth, demographic changes, or changes in the size of the economy — accompanied by an explanation of those changes.

Information about the reasons for year-to-year changes in spending is already easily available. The Congressional Budget Office annually publishes a table explaining the sources of growth in mandatory spending.[12] It shows, for example, how much Medicare spending goes up each year because of increases in the number of beneficiaries, in the reimbursement rates paid to health care providers, and in the frequency and intensity of use of health care services. This information is not new.

But focusing on year-to-year nominal dollar increases likely would foster the misleading impression that federal spending programs are always being expanded and taxes are always being increased, even when they are not. Tax revenues normally grow from one year to the next as the economy expands and personal incomes rise, without any increase in tax rates or change in tax laws. In fact, total tax revenues can go up in nominal dollars even when taxes are cut substantially, and expenditures for programs like Social Security and Medicare will go up in nominal dollars as the elderly population grows and health care costs rise, even if benefits in those programs are being cut significantly. Placing greater emphasis on year-to-year nominal changes could easily obscure rather than illuminate the forces driving the budget.

Moreover, those promoting anti-tax pledges could misuse the display and claim that the government was continuing to grow relentlessly and taxes were continuing to be raised on the American public, regardless of whether programs and taxes had both been cut. Since long-term deficit reduction will require both budget cuts and tax increases, this proposal — by being subject to ready manipulation by anti-tax advocates and potentially fostering serious misimpressions about the budget among the public — would likely make bipartisan deficit reduction harder to achieve.

---

[12] Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 2011-2020*, January 2010, table 3-4, page 61, http://www.cbo.gov/ftpdocs/108xx/doc10871/01-26-Outlook.pdf.