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Budget Enforcement Mechanisms

Mr. Chairman, Senator Hatch, and members of the committee, I appreciate the invitation to appear before you today.

The federal budget is on an unsustainable path. If we continue current policies — including a further extension of the 2001 and 2003 tax cuts and AMT relief — deficits will remain high throughout the decade, and the debt will rise to about 95 percent of gross domestic product (GDP) by 2021.

Raising taxes or cutting spending is difficult work that necessitates setting priorities and making substantive policy choices. Legislators understandably find it hard to agree on which revenues, if any, should be raised and which spending should be cut. At times like this, when progress seems glacial, policymakers seek new budget processes that might promote good fiscal behavior in the future.

Previous attempts to compel policymakers to make substantive budget choices by threatening painful automatic cuts have not achieved major deficit reduction, however, and enacting fixed deficit, debt, or spending targets may prove similarly ineffective now. The Balanced Budget Act of 1985 (known as Gramm-Rudman-Hollings) set annual deficit targets, with the aim of achieving a balanced budget, and imposed automatic spending cuts (termed "sequestration") if the targets were expected to be missed. Congress repealed Gramm-Rudman in 1990 because it failed. 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 used budgetary 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 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 procedures were backstopped by automatic spending cuts that applied to precisely the same programs specified in the Gramm-Rudman law (basic low-income programs, but not Medicare, were exempt from sequestration), 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)."[1] Lawmakers were intent on avoiding the automatic cuts. No one suggested that the threat could be ignored because the scope of programs subject to reduction was not sweeping enough.

Despite the failure of the Balanced Budget Act, proposals are again surfacing to change the budget process in an effort to force deficit reduction. For example, S. 245, introduced by Senator Corker, would limit federal spending to 20.6 percent of GDP, the average from 1970 through 2008. The spending levels of an earlier era, however, are inapplicable to the current budgetary situation, because they do not account for several fundamental changes in society and government: the aging of the population, substantial increases in health care costs since earlier decades, and new federal responsibilities in areas such as homeland security (following the 9/11 attacks), veterans' health care (including long-term obligations to care for those injured in Iraq and Afghanistan), and the prescription drug coverage for seniors that took effect in 2006.

The Corker bill would impose automatic, across-the-board cuts to close the gap between projected spending and the spending cap if the cap would otherwise be breached. If the cuts needed to reach the cap were achieved entirely through this mechanism, the estimated cuts would total about $1.3 trillion in Social Security, $860 billion in Medicare, and $550 billion in Medicaid just over the first nine years that the cap was in effect. Policymakers could avoid the across-the-board cuts by making specific cuts in specific programs to meet the spending cap, but to do so they would almost certainly have to enact the kinds of radical changes in Medicare and Medicaid and deep cuts in other programs that are included in the budget resolution the House passed on April 15. Indeed, CBO estimates that if all of the cuts in that budget were instituted, federal spending in 2030 would be 20¾ percent of GDP, a little *above* the Corker cap. Other proposals, such as S. J. Res. 10, would limit spending to even lower levels and would have even more severe consequences.

Placing such a cap on total spending would essentially absolve revenues — including tax expenditures — from playing any part in the effort to bring long-term deficits under control. In fact, it would encourage the conversion of spending programs into tax expenditures, which would not count against the cap. And it would favor subsidies provided through the tax code (which generally favor corporations and high-income individuals) over other forms of assistance (which primarily benefit low- and moderate-income people).

Imposing an arbitrary limit on federal spending would risk tipping faltering economies into recession, make recessions deeper, and make recovery from a recession more difficult. Spending for some important federal programs — including unemployment insurance, food stamps, and Social Security — increases automatically during a recession, when the need for assistance grows. Since GDP also shrinks during a recession and remains below its trend level during the early stages of

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[1] 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. Emphasis added.

recovery, federal spending increases significantly as a share of GDP during periods of economic weakness. This automatic response softens the recession's blow not only for the programs' beneficiaries but also for the economy as a whole by maintaining total purchasing power. Attempting to limit federal spending to a fixed share of GDP would "impinge on the stabilizers on the spending side of the budget," as CBO Director Douglas Elmendorf testified earlier this year. Taking away these stabilizers, Elmendorf warned, "risks making the economy less stable [and] risks exacerbating the swings in the business cycle."[2]

A global spending cap would also make it virtually impossible to address emerging issues such as climate change. Limiting the emission of greenhouse gases either by auctioning emission allowances (a "cap-and-trade" system) or by imposing a tax on carbon would generate *revenues* for the federal government. Much of these revenues would have to be used for related *expenditures*, such as offsetting the higher energy costs of low- and moderate-income consumers, financing increases in energy efficiency, and funding research into alternative sources of energy. Even though a climate-change bill would be deficit-neutral, under a global spending cap that would be irrelevant. Every new dollar of spending to combat climate change would require a cutting a dollar of spending in other programs — in addition to the deep cuts that would be required in any event. A spending cap would thus make climate-change legislation virtually impossible to pass.

Former Senator Pete Domenici and former Office of Management and Budget Director Alice Rivlin, co-chairs of the Bipartisan Policy Center's deficit-reduction task force, recently proposed a more promising budget enforcement process that they dub "save-as-you-go," or SAVEGO.[3] SAVEGO expands on the discretionary spending caps and pay-as-you-go procedures of the 1990 Budget Enforcement Act in a way intended to prompt policymakers to agree on the policy changes necessary to put the federal budget on a sustainable path.

Under SAVEGO, the President and Congress would establish a future debt-to-GDP target and a path to achieve it. Then, the debt-stabilization path would be translated into annual deficit-reduction amounts for separate categories of spending and revenues. If Congress failed to achieve the necessary savings, SAVEGO would impose automatic spending cuts and reductions in tax expenditures or other revenue increases within each category.

A plus of SAVEGO is that it would require specific amounts of budgetary savings, which are under the direct control of policymakers, rather than setting deficit or debt targets (as in Gramm-Rudman), which can shift when the economy or other factors change. It thereby avoids harming the economy by requiring larger budget cuts or tax increases when the economy weakens and smaller ones when the economy is strong.

Another positive aspect of SAVEGO is that the automatic changes would affect both spending and revenues. If an automatic mechanism affected mandatory programs but not revenues, reaching a deficit-reduction agreement would become less likely, since opponents of a deficit-reduction agreement that included revenues could achieve their goal simply by sitting on their hands.

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[2] Douglas W. Elmendorf, Director, Congressional Budget Office, Transcript of Testimony before the Senate Budget Committee, January 27, 2011, Federal News Service.

[3] Bipartisan Policy Center, *How SAVEGO Would Work*, April 13, 2011, http://bipartisanpolicy.org/sites/default/files/How%20SAVEGO%20Would%20Operate%20(4-28-11).pdf.

Moreover, SAVEGO would not necessarily limit the automatic changes affecting revenues to changes in tax expenditures, since it may prove difficult to design automatic cuts in tax expenditures in a way that would raise sufficient revenues.

Although aspects of the SAVEGO proposal raise concerns and would need modification, they can be addressed without changing the basic concept, which deserves consideration. In particular, the proposal does not explicitly provide for the exemption of low-income programs from sequestration, as has been the case under Gramm-Rudman and every one of its successors. It is essential that these exemptions be maintained in SAVEGO or any new budget enforcement legislation. As many of our nation's religious leaders have recently reminded us, "The nation needs to substantially reduce future deficits, but not at the expense of hungry and poor people."[4] There is no evidence that exempting low-income programs from sequestration weakens the enforcement mechanism; the exemption was part of the pay-as-you-go regime of the 1990s, when it proved a great success.

In conclusion, the history of the budget process suggests that it is difficult to design automatic mechanisms that will force agreement on actions to reduce the deficit. As Congress considers what steps to take next, it should learn from that history and avoid repeating the mistakes of the past.

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[4] Leith Anderson, President, National Association of Evangelicals, and others, *A Circle of Protection: A Statement on Why We Need to Protect Programs for the Poor*, April 27, 2011, www.circleofprotection.us.