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BUDGET PROCESS REFORM

The federal budget remains a chief concern of policy makers in Washington. Despite the massive tax increases in the deficit reduction efforts of 1990 and 1993, budget deficits are projected to be very large and to grow well into the next century. Proposals abound for a further major expansion of the role of government via health care reform and other mandates on business. Consequently, taxpayers should concern themselves with the federal budget and the federal budget process.

Concern over the budget cannot be restricted to concern over the deficit. It is essential to focus as well on the size of government and on the amount of regulation the government imposes on the private sector.

Past actions taken to control the budget deficit and the size of federal outlays have clearly been inadequate.

Past actions taken to control the budget deficit and the size of federal outlays have clearly been inadequate. The Congressional Budget and Impoundment Control Act of 1974 was supposed to bring order to the budget process, but it was followed by an explosion of federal outlays and a rise in the share of the economy controlled by government. The Gramm-Rudman-Hollings Act of 1985 (GRH) imposed deficit reduction targets, and succeeded in slowing the growth of spending for several years. The Act was gutted, however, when its spending restraint became too unpopular with the Congress and the President. GRH was altered and superseded by the Omnibus Budget Reconciliation Act of 1990, which increased taxes and has allowed a further ratcheting up of spending in real terms and as a share of the economy. Today, outlays are at near record levels as a share of Gross Domestic Product, and taxes remain above historical rates and act as a drag on economic recovery. (See graph on page 2.)

Institute for Research on the Economics of Taxation

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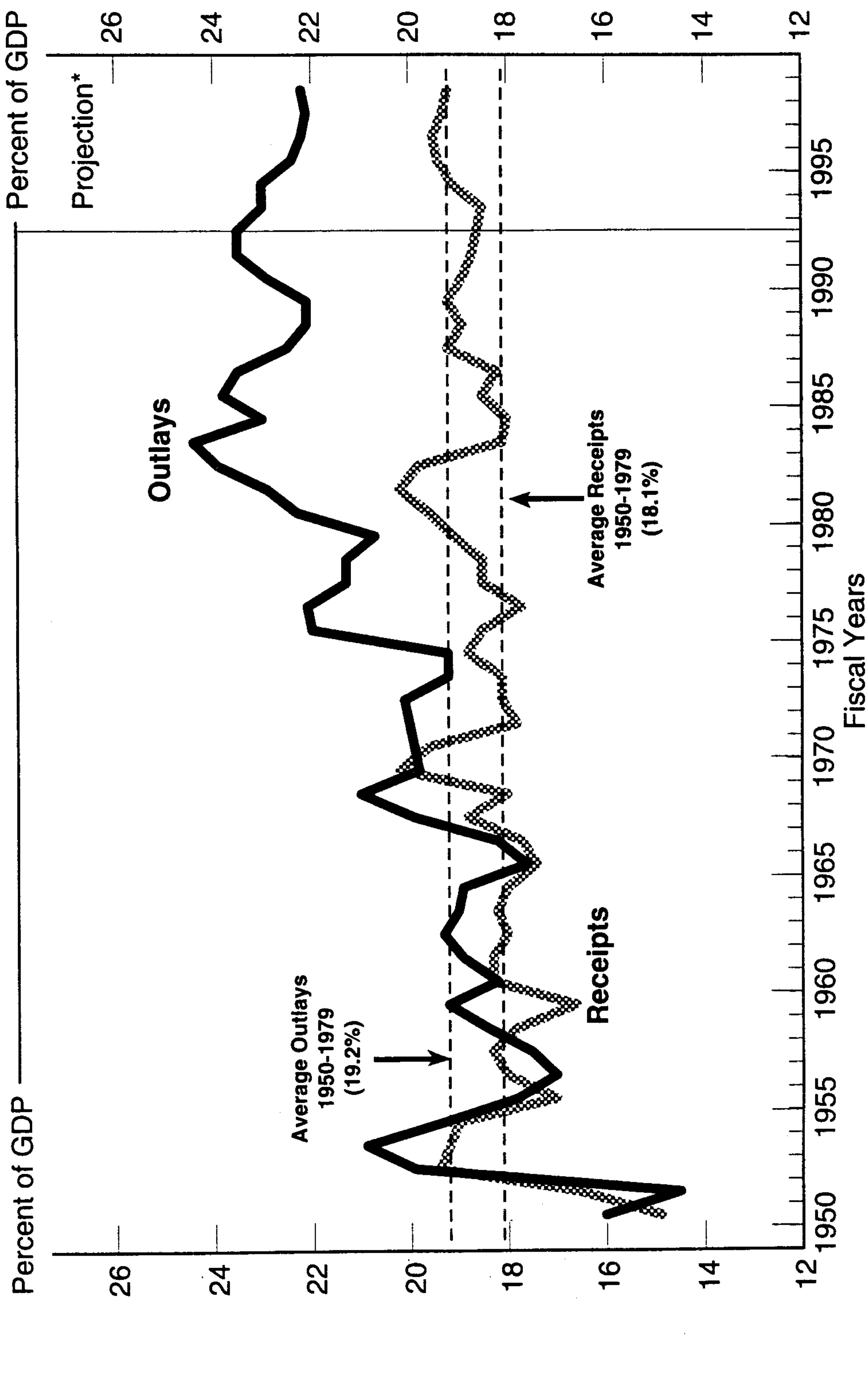
FEDERAL OUTLAYS AND RECEIPTS AS A SHARE OF GDP



* FY-1994 Mid-Session Budget projections. Based on CBO economic assumptions.

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Proposals to change or work around the budget process to trim spending

In light of the failure of existing budget practices to control outlays and deficits, several proposals have been made to bring spending under more effective control. Four leading proposals are examined here — the Budget Process Reform Act, The Common Cents Plan, the A-to-Z Plan, and the Taxpayer Debt Buy-Down Act. The first two amend the budget process itself to make it more likely to control spending. The last two allow budget-conscious Members of Congress or taxpayers to work around the budget process to restrain spending directly.

Cox-Stenholm and Lott-Shelby Budget Process Reform Act

Congressmen Christopher Cox (R-CA) and Charles Stenholm (D-TX) and Senators Trent Lott (R-MS) and Richard Shelby (D-AL) have proposed a major revision of the Congressional budget process. Their proposal, The Budget Process Reform Act (H.R. 2929, S. 1955), would curtail the rate of expansion of federal spending by bringing the President more fully into the budget process, by requiring super-majority votes in Congress to breach budget ceilings, and by giving the President enhanced rescission authority.

<u>Flaws in the current system addressed by the Budget Process Reform Act.</u> Under the present system, Congress is supposed to pass a preliminary concurrent resolution on the budget by April 15, and a final concurrent resolution by September 15, setting a revenue floor, a spending ceiling, and a target deficit. All appropriations bills for the federal departments and agencies are supposed to be enacted within the totals of the resolution by the start of the federal fiscal year, October 1.

Problems with the system have been many:

The budget resolution process ratchets up government spending.

! The budget resolution process ratchets up government spending. Each year's budget resolution figures begin with the "current services baseline" — a continuation of existing programs adjusted for inflation and eligible population growth — rather than actual spending in the previous year. Comparing spending proposals to the rising baseline makes increases in spending appear to be smaller than they really are, indeed, often makes increases appear to be spending cuts, and exaggerates the degree of any spending restraint that might be proposed. Programs in the baseline are seldom reviewed for value or effectiveness, and seldom cut. Then the Budget Committees add funds to enlarge existing programs and to finance new initiatives. The additional spending is triggered by the receptiveness of Congressmen and Senators to the urging of the pressure groups in their constituencies for new government services or the expansion of existing programs. Under the existing arrangements, there is no effective inhibition of policy makers' responsiveness to these pressures.

! Congress need not heed the President's budget recommendations. Concurrent resolutions do not require the President's approval.

! The President has no formal input in budget formulation beyond his initial budget submission to the Congress, and Congress is free to ignore that submission. The President's budget has been "dead on arrival" each winter for many years.

! Congress has missed deadlines repeatedly. The federal government has often begun its fiscal year on October 1 with no final budget resolution in place and with no appropriations bills approved for major agencies or departments. Congress has been forced to enact temporary extensions of spending powers — so-called "continuing resolutions" — to buy a few more days or weeks to work on a full-year budget.

! The final action on the budget has often been lumped into one huge "omnibus budget reconciliation act", running thousands of pages and containing billions of dollars of pork. This is then sent to the President for his signature just as the last continuing resolution is about to expire. Since the President lacks a line item veto, he receives the bill on a "take-it-or-leave-it" basis. To take it is to accept the pork. To leave it means leaving the government with no spending authority, forcing a shut-down of the federal government. Presidents have generally been reluctant to risk a shut-down.

! Actual outlays may aggregate to more than the amounts specified in the budget resolution. When an appropriation bill threatens to burst the budget act ceilings, the ceilings may be "waived" by a majority vote of the House Rules Committee or by a 60 vote margin on the Senate floor. The ceilings may also be circumvented by "open-ended" appropriations for entitlements, i.e., those that read "for such sums as may be necessary ..."

[The Budget Process Reform Act] H.R. 2929 and S. 1955...would correct many of the flaws of the present system, and would work to curb the ratcheting up of the growth path of government spending

Correcting the flaws. H.R. 2929 and S. 1955 would correct many of the flaws of the present system and would work to curb the ratcheting up of the growth path of government spending by giving policy makers an effective vehicle for resisting constituents' pressures.

! Scrap the current services baseline. The proposal would require the President's budget document and the Committee budget papers to contrast proposed spending with last year's actual outlays rather than to projections of current year outlays under existing law. This proposal is perhaps more cosmetic than effective; Members will need to know whether a proposed amount of spending on a program results in a real expansion or contraction after inflation, and whether or not the program will be affecting more or fewer people — i.e., the current services projection. The proposal's authors hope, however, that it may lead the Members to reconsider the value of existing programs with an eye toward cutting them to finance new initiatives or for deficit reduction and that it would prevent Congress from making a spending increase look like a reduction.

! A binding budget law. Under the proposal, Congress would be required to enact a legally binding budget law by April 15 of each year. A budget law, unlike a concurrent resolution, would require the President's signature, could be vetoed by him if he did not like its content, and could then be enacted only through a veto override. Furthermore, the April deadline would severely compress the time in which pressure groups can lean on policy makers.

! The budget law would set spending limits in 19 broad federal spending categories, including entitlements, excepting only social security and interest payments on the national debt. Detailed allocations would not be permitted at that stage of the budget process in order to curtail pressures from spending constituencies to build in margins for their particular programs.

! An automatic continuing resolution to end the threat of shut-down. If Congress and the President failed to enact a budget law, an automatic continuing resolution would come into force for the entire new fiscal year, continuing spending ceilings indefinitely for the 19 budget categories at the previous fiscal year's levels.

! Under the proposal, failure to agree on new budget totals does not mean shutting down the government. It leads only to a permanent continuing resolution that limits spending to the previous year's levels, allowing the President to hang tough against unjustified spending increases without fear of drastic dislocations.

! Since most categories of spending are increased in each successive budget, and a new budget law would generally reflect this rising trend, the continuing resolution would usually be less generous than a new budget law. This gives Congress an incentive to reach a consensus on a new budget law by April 15, instead of the current situation of frequent stalemate and missed deadlines.

! Super-majorities required to exceed budget ceilings. Once a budget law was passed, Congress could appropriate funds by majority vote up to the budget ceilings for each major category of spending. It could legislate to exceed the ceilings in the budget law only by obtaining super-majority votes — two-thirds of the members voting in the House and three-fifths of the members voting in the Senate. If Congress failed to pass a budget law, a similar super-majority vote would be needed for any appropriations bill (i.e., any appropriation differing from that of the automatic continuing resolution).

! Enhanced rescission powers for the President. Under the proposal, if Congress by a super-majority vote enacted spending legislation exceeding the budget law ceilings (or those of the continuing resolution), the President could veto the bill, but the veto might be over-ridden. To further strengthen the President's hand, the proposal would empower the President instead to alter the bill to reduce the excess spending for the offending programs by enough to bring their totals to within the budget law (or continuing resolution) ceilings, and then sign the bill, avoiding a veto override.

! If the President exercises that rescission power, Congress would have to pass a bill to overturn his action with respect to the excess spending, which he could then veto. Members are less likely to override a veto of a bill dealing only with excess spending than a veto that threatened the entire appropriation for a budget category.

! Elimination of waivers and open-ended appropriation. As a further constraint, the proposed law would ban "waiving" the budget resolution, and would outlaw open-ended appropriations by requiring specific dollar amounts for each appropriation measure.

H.R. 2929 and S. 1955 are not foolproof any more than are the budget caps under present law. They do not have the force, for example, of a Constitutional Amendment. Congress could always vote to repeal or amend the new process. However, such a step would be far more difficult than using the waiver provisions of the current process.

H.R. 2929 and S. 1955 are not foolproof any more than are the budget caps under present law...[but] By strengthening the hand of the President in developing the budget totals and in rescinding outlays, and by requiring super-majorities to spend in excess of budget ceilings, it would tilt the legislative playing field in favor of a gradual reduction in outlay growth.

H.R. 2929 and S. 1955 contain no specific mechanism for cutting spending from current levels without the active support of the Congress or the President. The proposal would be greatly fortified in that respect by enactment of the Walker-Smith debt buy-down proposal. Even so, it would be a very large step in the right direction. By strengthening the hand of the President in developing the budget totals and in rescinding outlays, and by requiring super-majorities to spend in excess of budget ceilings, it would tilt the legislative playing field in favor of a gradual reduction in outlay growth. There would be no sudden budget shock as might occur under a balanced budget amendment or rigid deficit reduction targets.

The Common Cents Budget Reform Act of 1994

The Common Cents Budget Reform Act of 1994 (H.R. 4434), introduced by Representatives Charles Stenholm (D-TX), Tim Penny (D-MN), and John Kasich (R-OH), would alter the mechanics of the budget process in Congressional committees, on the floors of the House and Senate, and with respect to Presidential involvement to tilt the process more toward restraint of spending growth. The first of the four provisions is somewhat cosmetic, but the other three are significant improvements on current practice.

! Reforming baseline budgeting. The bill would require the President and the Congressional Budget Committees to compare their budgets to the amount actually spent in the prior year, rather than to the baseline budget adjusted for inflation, population growth, and effects of previously scheduled changes in the law. It would amend the definition of the baseline to exclude automatic increases in discretionary spending. As discussed above, downplaying the baseline would not stop Members from asking whether a given level of spending raised or lowered real outlays or altered a program's eligibility requirements. The authors hope, however, that the proposal will make Members more likely to review existing programs for possible reductions, rather than simply taking them as given and building upon them, and that it would prevent Congress from making a spending increase look like a reduction.

! Using spending cuts to reduce deficits. The proposal would allow Members to direct that some or all of any saving from floor amendments that cut appropriations bills be used to cut the deficit. The spending ceiling in the budget would be reduced by the amounts saved, so that the saving would not merely make room for additional outlays on other programs.

! Enhanced rescission powers for the President. The bill would strengthen the President's ability to block spending by requiring that the Congress vote on any rescissions submitted by the President, rather than simply ignoring them. The President could force a vote on eliminating questionable items in an appropriations bill or specific tax provisions in a tax bill without vetoing the entire bill.

The Common Cents Budget Reform Act of 1994 (H.R. 4434)...would alter the mechanics of the budget process in Congressional committees, on the floors of the House and Senate, and with respect to Presidential involvement to tilt the process more toward restraint of spending growth.

! Controlling emergencies. The Budget Enforcement Act of 1990 (part of the Omnibus Budget Reconciliation Act of 1990) capped discretionary spending, but it provided a loophole for "emergency" outlays. The proposal would prevent the abuse of this loophole by requiring that any emergency spending bill be free from any non-emergency items, and that each "emergency" be considered on its own merits in a separate supplemental appropriations bill to discourage logrolling.

The A-to-Z Plan

The bipartisan "A-to-Z" spending cut bill (H.R. 3266), sponsored by Representatives Rob Andrews (D-NJ) and Bill Zeliff (R-NH), would convene a one-time, special session of Congress dedicated to considering reductions in federal expenditure programs. The special session, held over a 10 day period, would be restricted to spending cuts and no program would be off limits. Discretionary and "entitlement" programs would all be fair game. Entitlement spending now comprises over half the federal budget and increases automatically without Congressional review. Every Member of the House could offer a spending reduction initiative for discussion and a vote by the full House. No spending cut proposal could be bottled up either in an authorizing Committee or the Rules Committee.

The A-to-Z plan would not guarantee any spending cuts. If members of Congress believe that all programs are effective and that every dollar the government spends is better used there than in reducing the deficit or being returned to taxpayers, they could — in recorded votes — direct that no federal program be downsized. What the A-to-Z plan would do is make members of Congress more accountable to voters by forcing them to go on record as to exactly where they stand regarding the size of specific spending programs.

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The group spearheading the A-to-Z effort consists mostly of newer members from both sides of the aisle, who are trying to open up the budget process with respect to spending restraint. Their initiative represents an end run around senior members of Congress, both in the leadership and at the controls of powerful committees, who are using their positions to protect numerous programs from serious scrutiny. The House leadership and the Committee Chairmen fiercely oppose A-to-Z.

Opponents of the A-to-Z plan charge that it could lead to significant cuts in major federal programs without the chance for the reflection provided by committee hearings and deliberations. Supporters counter that far from examining government programs with open minds, many committees have become burying grounds for proposals to restrain spending. Moreover, the argument that spending cuts should first be evaluated at the committee level would be more convincing if similar deference were followed on the spending increase side. Unfortunately, it is common for committees to add big spending increases to bills they are crafting with little or no prior discussion, often at the last minute. Advocates of A-to-Z see it as providing a badly needed forum for reconsidering those programs.

The A-to-Z bill is drafted as a one-time assault on existing waste in the budget. It would also constitute a warning to the Committee Chairmen and the House leadership not to let things get so far out of hand in the future. There is no reason, however, why the procedures of the A-to-Z plan could not be made a permanent feature of the operations of the House. It would certainly make that institution a more open and (small-"d") democratic place.

Walker-Smith Taxpayer Debt Buy-Down Act

An efficient fiscal system would confine government spending to the amount the public is willing to pay for in taxes. Such a system obviously requires effective communication between taxpayers and public policy makers. This communication clearly has been largely lacking. The American public disapproves of budget deficits, believes government is too large and too intrusive, and is not willing to pay additional taxes to reduce, let alone eliminate, the huge deficits in prospect for the indefinite future.

The Taxpayer Debt Buy-Down Act (H.R. 429, S. 449)...would provide taxpayers with (1) an effective tool for communicating their tax and spending preferences to policy makers and (2) an effective device for ensuring that the policy makers implement taxpayers' preferences.

The Taxpayer Debt Buy-Down Act (H.R. 429, S. 449), introduced by Representative Robert Walker (R-PA) and Senator Robert Smith (R-NH), would provide taxpayers with (1) an effective tool for communicating their tax and spending preferences to policy makers and (2) an effective device for ensuring that the policy makers implement taxpayers' preferences. It would allow individual taxpayers to designate up to ten percent of their income tax liability to be allocated to a trust fund to be used exclusively to buy back federal debt held by the public. For every dollar so designated, Congress would be required to reduce spending by a dollar in the upcoming fiscal year. The spending reduction is envisioned eventually to eliminate the federal deficit, move the budget into surplus, and subsequently reduce the outstanding federal debt.

Mechanics:

- On May 1st of each year (after the April 15 filing deadline for final income tax returns) the Treasury would estimate the amount designated by the taxpayers.

- Congress would have from then until the end of the session to achieve the designated amount of cuts in discretionary spending or entitlements, in whatever programs they feel can best bear the reductions.

! If Congress and the President failed to enact sufficient spending cuts to match the amount designated by the taxpayers, an across-the-board sequester of all budget accounts except Social Security, Deposit Insurance, and interest on the federal debt would go into effect to achieve the required outlay reductions.

It is the intent of the sponsors that all spending cuts made as a result of the taxpayer designations be permanent reductions in programs. That is, there is to be a reduction in baseline spending (outlays required to maintain programs under current law) for the current year that will carry over into all future years. Lowering the starting point of the current baseline reduces spending by a growing amount each year for two reasons. First, many programs grow over time, and x percent of a rising number is a rising number. Second, the reduction in spending will lower future interest payments on the debt.

Unfortunately, the proposal as drafted does not contain any mechanism for preventing Congress from creating additional spending programs that would raise the budget baseline to offset the reductions imposed by the taxpayers. Some sort of spending cap, based on the projected baseline as of the date of enactment, would have to be added to the proposal to make it fully effective. These caps would have to be similar to the current spending caps on discretionary spending enacted under OBRA90, and to the PAYGO provisions covering entitlements, with the difference that new spending would have to be offset by cuts in existing programs, not by tax increases.

One objection that opponents of the proposal might raise is that the only votes counted in this taxpayer referendum on spending are "no" votes. There is no mechanism for taxpayers to vote for more than the existing level of spending. Indeed, if binding spending caps were added to the proposal, government outlays would forever fall below, by increasing amounts over time, the projected baseline amounts as of the year the provision became effective. Perhaps taxpayers should be permitted to counter "no" votes by paying more than their tax liability, with the excess dedicated to raising spending.

Although it is in need of additional language, the bill represents a constructive effort to improve the existing federal budget process. Its enactment and implementation would very likely result in a material slowdown in the growth of federal spending and in more constructive federal programs. Just as important, it would create an effective means by which the taxpayers could communicate their wishes regarding spending to policy makers in the Congress and in the Executive Branch, and lead to a level and composition of federal activities conforming more closely with the preferences of the public as a whole.

<u>Expected Results of Implementing H.R. 429.</u> There is little information on which to base confident estimates of the magnitude of the spending and deficit reductions that would result under H.R. 429. The Congressional Budget Office has provided estimates of the budget effects assuming that all individual income taxpayers would assign the maximum amount — 10 percent — of their tax liabilities to the debt buy-down trust fund, hence require equal spending reductions from the fiscal year base line amount. On these assumptions, as the attached table shows, budget outlays would peak

in the year 1998 and begin to decline slowly in the year 1999. The budget deficit, on the other hand, would begin to decline substantially from projected baseline levels beginning in fiscal year 1995; surpluses would replace deficits beginning in the year 1998 and would increase substantially thereafter. The debt held by the public would peak in the fiscal year 1997 and fall rapidly thereafter.

Of course, these results would be altered if the baseline projections were revised, particularly if there were changes in tax revenues because of changes in the tax laws or changes in underlying economic conditions. Furthermore, the CBO estimates are outside estimates. In all probability, the actual designations by the taxpayers would be somewhat smaller than the maximum allowed, resulting in smaller cuts in spending and in budget deficits. Nonetheless, the CBO projections are useful as indicators of the potential of H.R. 429 for imposing an effective discipline on policy makers' decisions about aggregate federal spending.

Deficit control is not enough. The size of government must be controlled as well if the economy is to function more efficiently...no budget process will yield good results if special interests exert sufficient pressure on the Congress to tax the rest of the country to transfer to their pockets income that they cannot earn in the market.

Conclusion

Many options are available for improving the budget process, reducing the deficit, and controlling federal spending, and limiting the size of government. Deficit control is not enough. The size of government must be controlled as well if the economy is to function more efficiently. Balanced budget amendments, statutory changes in the budget process, or creation of a taxpayer debt buy-down process all have appeal, and all have limitations. It is even possible for Congress to pass responsible spending legislation under current rules when the will is present. It is encouraging to note that both the House and the Senate recently passed "Sense of the Congress" amendments to the non-binding FY 1995 Budget Resolution that recommend comparing spending levels in future budgets against current year expenditures instead of inflated baseline projections.

The will to do the responsible thing is the key to proper government. That observation applies to the public as well as to the Members of Congress. Ultimately, no budget process will yield good results if special interests exert sufficient pressure on the Congress to tax the rest of the country to transfer to their pockets income that they cannot earn in the market. Still, one can try to set the rules to make these unwarranted taxes and income transfers as difficult as possible to enact.

Stephen J. Entin
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ILLUSTRATIVE MAXIMUM EFFECTS OF WALKER-SMITH PROPOSAL

(Dollar amounts in billions)

Fiscal year	1993	1994	1995	1996	1997	1998	1999	2000	2001	2001	2003
Assumed "Check off" Amount a/	$51	$55	$59	$63	$66	$70	$74	$78	$81	$85	$89
Automatic Spending Cuts b/											
Nonexempt programs c/	0	0	-51	-107	-172	-242	-321	-409	-506	-613	-731
Interest savings	0	0	-1	-6	-15	-27	-45	-68	-98	-136	-182
Totals	0	0	-53	-113	-186	-269	-366	-477	-604	-749	-913
Resulting Total Budget Outlays	1,416	1,497	1,476	1,479	1,484	1,478	1,474	1,463	1,445	1,419	1,380
Deficit (-) or Surplus (+)	-266	-253	-144	-76	-12	69	143	227	323	429	554
Debt Held by the Public	3,249	3,507	3,661	3,753	3,785	3,736	3,614	3,409	3,107	2,699	2,166
Maximum Effect on Sequestrable Programs											
Baseline Outlays for Nonexempt (Sequestrable) Programs d/	1,009	1,031	1,060	1,094	1,144	1,192	1,259	1,329	1,406	1,488	1,576
Cumulative Sequestration /c	0	0	-51	-107	-172	-242	-321	-409	-506	-613	-731
Resulting Outlays for Nonexempt Programs	1,009	1,031	1,008	986	972	950	937	920	900	874	845
Percentage Reduction for Nonexempt Programs	0%	0%	-5%	-10%	-15%	-20%	-26%	-31%	-36%	-41%	-46%

Source: Statement of Robert D. Reischauer, Director, Congressional Budget Office, before the Subcommittee on Select Revenue Measures, Committee on Ways and Means, U.S. House of Representatives, November 16, 1993.

a. CBO has based this analysis on the assumption, previously specified by Congressman Walker, that all individual income tax payers would choose the maximum "check off," 10 percent of liabilities. Although tax collections (on a fiscal year basis) are not the same as liabilities (which are on a calendar year basis), they are similar enough for this illustration.

b. Taxpayers would designate the "check off" in returns filed on or before April 15, and sequestration would begin in the following October (or at the end of the Congressional session, if later). Hence, there is a two year lag between the time taxpayers incur liabilities and the spending cuts that they could order.

c. According to Congressman Walker's staff, it is intended that a single year's "check off" should generate savings in all future years, as programs are barred from returning to previous spending plans or benefit formulas. Additional legislative language would be needed to achieve this result.

d. In Congressman Walker's proposal, only Social Security, deposit insurance, and net interest are exempt. Offsetting receipts are effectively exempt because they are not associated with sequestrable budgetary resources. The Congress can substitute other spending reductions (but not revenue increases) for the required sequestration.

Note: Nothing here is to be construed as necessarily reflecting the views of IRET or as an attempt to aid or hinder the passage of any bill before the Congress.