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U.S. House of Representatives

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Chairman Ryan, Ranking Member Van Hollen, and members of the Budget Committee, thank you for inviting me to share my views on the federal budget process. The views I will express today are informed by 20 years of both participating in—and studying—the budget process. Based on this observation, I would agree with many who would say that the budget process certainly does not appear to have done a very good job of helping us to solve the current budget problems that we face. I would argue, however, that the main problem is not that the budget process is broken—it is that the tools that are available have not—at least recently—been used to devise solutions to the problems that we face.

I would like to start by observing that I think taking a long look at the budget process and (particularly) budget concepts can have a positive effect. It is, however, a big job—one that is fraught with difficulty. This difficulty takes at least two forms. The first is that there are entrenched interests who like the budget process just the way it is because it enables them to achieve their desired policy ends. The second is that, because there are so many directions that you could go, the Congress might spend its time on tempting reform targets that will not really have much payoff. I don't think there is much that can be done about the first problem, and in any event I don't mean to suggest that you duck difficult reforms that may work because they would be opposed by entrenched interests. But I do advise you to steer you away from reform ideas that we have already tried and we know not to work. In

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particular, I hope that you avoid the temptation of assuming that fiscal rules will solve our macrobudgetary problems. In fact, my main message is that most of the tools that you need to solve the budget problems faced by the country are already in your toolbox. If the goal is to deal with the larger fiscal imbalance that faces us, the most important thing to do is to make use of them, not search for more tools.

### What is Our Experience with Fiscal Rules since 1974?

First, I think it is useful to remind ourselves of where we have been. Since 1974 we have attempted a number of approaches to deal with the budget, and later the budget deficit. These efforts have yielded some lessons that I think are useful to consider in the context of budget reforms that the committee might consider this year.

The Congressional Budget and Impoundment Control Act of 1974, which established the budget resolution and this committee, was designed to address at least two major flaws in the process as it existed at that time. First, the budget was adopted on a piecemeal basis. That is, there was no point at which the Congress focused on the whole budget. Rather, many separate bills—covering tax legislation, mandatory spending, and discretionary appropriations—were considered. In total, these made up the “budget”, but the totals were more or less the accidental result of these many separate legislative actions. Second, the budget was only a one-year-at-a-time phenomenon, with little attention paid to the medium-or-long term budgetary or economic effects of policy.

The Budget Act of 1974 attempted to address these shortcomings by establishing a budget resolution, which would represent a comprehensive statement by the Congress of its priorities, and would cover multiple years. The notion here was that the Congress would first decide on a path for aggregate fiscal policy, and then would impose limits that its committees would be required to adhere that would be

consistent with these aggregate limits. Institutionally, the establishment and enforcement of the budget resolution would be under the jurisdiction of the House and Senate Budget Committees. They would be supported in this by the Congressional Budget Office (CBO), which would both establish a multi-year budget baseline (starting point) for budget deliberations, and would track the economic and fiscal effects of legislation over multiple years, in part to ensure that the strictures established by the budget resolution were adhered to.

This was all well and good, except that there was nothing about the budget process created in 1974 that necessarily forced it to confront the large deficits that began to surface by the mid-1980s. The Balanced Budget and Emergency Deficit Control Act of 1985 (later revised in 1987), also known as Gramm-Rudman-Hollings (GRH), attempted to put the budget on a glide path to balance by setting fixed deficit targets, over multiple years. The bill was passed as an amendment to a bill to increase the government's debt limit, partially to give some cover to those who voted for the debt increase. Adherence to these targets was enforced through sequestration. If estimated deficits (as enacted in the budget resolution) would exceed the GRH targets, across-the-board spending cuts were enacted. The sequestration process excluded a significant number of programs, however, including Social Security and most of Medicare.

The Gramm-Rudman-Hollings legislation was a watershed event, because it explicitly focused the budget process, for the first time, on attempting to get a handle on out of control budget deficits. The law set annual targets for budget deficits, with an ultimate goal of a balanced budget within five years. While there is a credible argument that GRH had some effect on spending and deficits, it did not come close to meeting its overall goals. In fact, the fiscal year 1993 budget, which was to be balanced under the revised 1987 targets, had a deficit of \$255 billion. The failure of GRH to meet its objectives stemmed primarily from its focus on estimated, rather than actual, deficits. Policymakers tended to meet the projected deficit targets through systematically optimistic forecasts, particularly of economic growth.

These optimistic forecasts were embraced by both the President and Congress, and by both Republicans and Democrats. Further, the sequestration process lacked credibility, in part because it exempted large portions of the budget on the spending side, and in part because it included only spending changes, and not automatic tax increases.

The failure of GRH to reduce deficits to manageable levels contributed to the search for a different approach, which ultimately culminated in the Omnibus Budget Reconciliation Act of 1990. This act combined spending cuts and tax increases to reduce 1991-1995 deficits by an estimated \$500 billion. It also included a new procedure, called the Budget Enforcement Act (BEA), which combined statutory caps on discretionary programs with a new pay-as-you-go (PAYGO) system designed to prevent new actions from undoing the effect of the deficit-reducing actions enacted in 1990. Under PAYGO, if mandatory spending was increased or taxes decreased, this needed to be accompanied by action to reduce mandatory spending or increase taxes in order to make the overall effect “deficit neutral”. Both the caps and PAYGO were enforced on a multi-year basis.

The BEA approach differed from GRH in two main respects. First, it focused on the policy actions first, and THEN enforcing those actions—attempting to prevent the Congress from undoing the actions already agreed to. Thus, the option of avoiding the deficit-reducing policy actions by assuming that the problem had been solved was not available. Second, rather than one sequestration, there were two, focused on the distinction between discretionary and mandatory spending (and taxes), under the assumption that policymakers should be held accountable for things that they could control. For example, a failure to meet the discretionary caps would lead to a sequestration of discretionary spending rather than all spending.

The BEA approach survived the 1990s. New five-year reconciliation bills were passed in 1993, and again in 1997. These new bills tended to be passed before the prior multi-year agreement expired, in an effort to make changes necessary to

respond to changing budget or political realities. The BEA process itself was extended until 2002, but the onset of budget surpluses in fiscal year 1998 ultimately led to its downfall. Congress and the President resorted to loopholes starting in the late 1990s, such as declaring funding for the conduct of the 2000 census to be an emergency. (This seemed to many to stretch the emergency designation more than a little, since the requirement for the decennial census is in the U.S. constitution.)

The 1997 Act represented the final time until 2011 that the Congressional budget process was used to enact a multi-year deficit reduction deal. While there were subsequent uses of reconciliation during the 2000s, all of them had the effect of adding to deficits rather than reducing them. These included the 2001 and 2003 Bush tax cuts, and the 2003 Medicare prescription drug bill. While a statutory PAYGO law was enacted in 2010, it includes a number of sequestration exemptions that limit its usefulness. In 2011, there was some movement toward multi-year deficit reduction through the enactment of the discretionary spending caps included in the Budget Control Act.

In the end, there are a number of lessons about the relationship of the budget process to deficit reduction that emerges from the experience of GRH, the BEA, and the post-BEA era.

1. Setting targets without simultaneously reaching consensus on policy actions to reach those targets may be an empty promise. The major failing of GRH was that it did not require anything of its drafters, other than a promise to do something later. This is also a major failing of constitutional amendments requiring annual balanced budgets. If there are going to be targets, they should be accompanied by (at least a substantial down payment on) the policy actions that are required to meet them.

2. Even if we are going to set future targets, promises to reduce projected deficits, with no attention to actual deficits, invites unrealistic projections. Meeting

projected targets is not that hard. Under GRH, doing something later ended up often meaning cooking the numbers to appear to meet the goals, rather than actually meeting them.

3. Enforcement must be comprehensive, and must encourage participants to reach agreement. A major shortcoming of the GRH process was that some participants (particularly those who opposed tax increases or cuts in major entitlement programs) believed that they were better off with sequestration than they would have been actually agreeing to a deal. If many policies are excluded from enforcement, then the ability of the enforcement process to promote a deal is more limited. I would therefore encourage that any enforcement regime not only include all spending, but automatic revenue increases.

4. The budget process is better at enforcing compliance with agreements than to make those agreements happen. Any process is limited in its ability to actually make something happen, if the participants do not have the incentive to act. All of the successful efforts at deficit reduction in the last three decades have one basic thing in common. The President and the Congress agreed on a future path for the budget and on a set of policy actions, and then the process was used to enforce compliance with those actions.

5. The budget process must recognize the particular responsibility that the federal government has to respond to economic downturns and other emergencies. It is important that the federal budget process remain flexible. Thus, when the deficit rises because of the deterioration of the economy, it is important that this not require spending cuts and tax increases, at precisely the time that they would be most difficult, and economically and politically harmful, to enact. If it had been imperative that the government reduce its deficit during the recent recession, it would have made state and local governments and individual citizens much more vulnerable to the effects of the economic downturn. While there have been

tendencies in the past for emergency designations to be abused, it is important to maintain the ability of the process to respond to unforeseen circumstances.

6. Enforcement mechanisms should hold policymakers accountable for things that they can control. The BEA, by focusing on enforcing actions that had already been taken, and by holding Congressional committees responsible for actions under their control (appropriators for discretionary spending, and authorizing committees for PAYGO actions) was more successful in maintaining budget discipline, at least until deficits were replaced by surpluses, at which point the consensus that had developed around deficit reduction had fallen apart.

#### The Problem with Overall Fiscal Rules

There is no real disagreement about the larger budget problems that we face. They have been well documented. The numerous commissions, in addition to several directors of CBO, Comptrollers General, and even some (but not all) Presidents and many members of Congress have delivered the consistent message that we eventually have to confront the fiscal challenges that we face.

I am VERY skeptical, however, about how useful budget process reforms can be in making us confront those challenges. Thus, I would advise against spending a lot of time and energy trying to come up with rules that force people to act more responsibly later. It is better to spend time and energy searching for a set of policies that will reduce projected deficits and debt, and then use the budget process to enforce adherence to the fiscal path implied by those policy changes.

It is in this context that I think the balanced budget amendment to the constitution is ill-advised. Certainly there are many arguments against a balanced budget amendment, including that it often is not sufficiently flexible to allow the federal government to respond in times of economic and other emergencies, and that it is

problematic to put spending limits into such an amendment. I would mainly stress two flaws in the balanced budget amendment.

The first is that it is a distraction from the problem that we face right now. It would take perhaps seven years to figure out whether the state legislatures would ratify it (they would not, in my view, since many would figure out that it is not in their interest for the federal government to balance its budget on an annual basis). Moreover, it is not self-enforcing. It would take legislation to enact the changes in laws necessary to increase revenues and reduce spending, and further to enforce compliance with the amendment. If we could enact those policy and budget enforcement changes, we would not need the amendment. If we were to pass the amendment, we would still need to do those two things.

Secondly, it relies on erroneous ideas about debt in our society. It turns out that it is not only the federal government that does not balance its budget. Families have mortgages; they have car payments; they have student loans. State and local governments balance their operating budgets, but they borrow to build highways, or dormitories, or prisons. Equally, businesses carry debt. Borrowing is a fundamental part of the financial model for families, governments, and corporations. Used correctly it can be very productive and result in measurable gains. The problem is not that the U.S. government has debt: it is rather that the fiscal imbalance is too large, and is too heavily weighted towards debt that does not make us better off in the long-run. These would both be good things for the Congress to address. Neither of them is addressed by a requirement that the government balance its budget on an annual basis.

If the goal is reducing the current level of debt in the medium-term and enacting budgets that maintain budget discipline in the longer term, it is my view that the Congress already has the major tools that it needs. The budget resolution itself is designed to set targets for multiple years, and those targets can (and should) reflect the desire to reduce deficits to a manageable level of GDP. Moreover, it is the

reconciliation process that has been most successful, if success is defined as assisting the country to deal with deficits on a multiple-year basis. Particularly during the decade of the 1990s (with separate reconciliation bills passed in 1990, 1993, and 1997) reconciliation was used to enact policies that reduced the deficit over multiple years. Certainly reconciliation can have the opposite effect on the deficit, as we saw during the 2000s. That does not have to do with the structure of reconciliation, but the political consensus around the actions that it is used to make.

In the end, this demonstrates one of the limitations of reconciliation, and indeed the whole budget process. It can act as a vehicle to enact policies, but it cannot force a particular set of policies to be enacted, or a particular economic or fiscal path to be followed. Thus, in the 1990s, it was used to promote fiscally responsible policies, because there was a political consensus around that fiscal direction. In the 2000s, there was a consensus around lower taxes and more spending, and the process was used to promote these outcomes. Thus the process does not demonstrably encourage fiscal responsibility, but can make that responsibility easier to achieve if there is a consensus to follow such a path. I certainly think that if the Supercommittee is successful in coming up with policies to reduce future deficits, that accompanying that with BEA-like enforcement mechanisms that attempt to prevent future Presidents and Congresses from undoing those policy actions will be essential. Even there, however, history demonstrates that if a future President and future Congress want to get around those rules, they will find a way to do so.

### What about Other Reform Ideas?

There are, of course, lots of other things that you could focus on that are not directly related to the short terms deficit problems facing the country. There are, as is true in most years, seemingly as many of these ideas as there are members of Congress to propose them. While I will not attempt to look at all of these proposed reforms, there are four current proposals that this committee may be asked to consider that I

have thought about—biennial budgeting, a joint budget resolution, sunset review, and expedited rescission. I will share at least some summary thoughts on these.

*Biennial budgeting*—One frequently mentioned proposal is to change from an annual to a biennial budget. Since Congress has such difficulty acting on a budget, why not simplify the problem by requiring action only every other year? Most biennial budgeting proposals would have the president submit his budget biennially and would also feature biennial budget resolutions and appropriations. Perhaps the high-water mark for biennial budgeting came in 1993, when both the Joint Committee on the Organization of Congress and Vice President Gore’s National Performance Review recommended that the federal government adopt a biennial timetable for the process. Proponents of biennial budgeting argue that the current annual process features repetitive votes on many fiscal issues that eat up valuable committee and floor time. Second, in a related issue, supporters note that time spent on budgeting cannot be spent on other activities, particularly detailed oversight of federal programs.

While enthusiasm for a biennial budget is understandable, given the distaste with the continual nature of the budget process, this reform probably would not have much effect on either the time spent on budgeting or on the level of oversight exercised by Congress. On the first issue, the federal government has a rather checkered history of budget forecasting. Producing a budget every two years would increase the probability that budgets would be based on erroneous information, and would therefore need to be redone. The biennial process may degenerate into an annual process, given the uncertainties associated with budgeting for a \$4 trillion enterprise. Further, an increase in oversight under biennial budgeting would occur only if the current lack of oversight results from a lack of time. Even if members of Congress had more time to do oversight, they would not be likely to do more of it simply because they do not have any incentives to spend precious time understanding more about how federal programs work in great detail.

*Joint Budget Resolutions*—Unlike the present requirement for a concurrent budget resolution, a joint resolution would require the President’s signature, and thus would be a law and binding on subsequent Congresses. With a joint budget resolution, the President would be given the authority to veto the budget resolution as passed by Congress. Requiring that the budget resolution be a law in order to take effect would give it more weight than it bears as just a set of rules the Congress creates for its own use. Further, if a joint budget resolution worked as advertised, it would improve the timeliness of the process by facilitating agreement earlier in the Congressional session.

While I think that promoting earlier agreement is a laudable goal, it seems unlikely that a joint resolution would make earlier agreement between the President and Congress more likely to occur. In years in which the President and the Congress are inclined to agree with each other on the outlines of the budget, requiring the President’s formal approval is not likely to change much. Therefore, during periods of unified government (that would represent 14 of the 37 years between 1975 and 2011), a joint budget resolution would have been unlikely to influence timeliness of the budget process. The President and the Congress already have incentives to agree on the broad outlines of policy in those years. Alternately, if the President and the Congress do not agree on even the broad outlines of policy (as seems likely during periods of divided government—the other 23 years since 1975), requirement for a joint budget resolution could stop the budget process dead in its tracks, to an even greater degree than exists today. To the extent policy and priority conflicts define Presidential-Congressional relations, a joint budget resolution would simply front-load those conflicts, increasing chances that the budget resolution would be delayed or that there would be no budget resolution at all.

*Sunset Provisions.* Sunset review proposals put government programs on a set timetable for review and possible abolition. In a sense, many federal programs and agencies are already subject to sunset review, since they have to be periodically

reauthorized. The reauthorization process, however, frequently does not focus comprehensively on whether programs work or not. In fact, examples of programs that are abolished because they do not work are few and far between. States have often used sunset review, with mixed results. If sunset review was to be used at the federal level, it would be most effective if it was accompanied by systematic efforts to assess the performance of the programs under review. This type of performance measurement is anticipated under the Government Performance and Results Act Modernization Act of 2010, which attempts to build on the last 20 years of progress in establishing performance measures for federal programs. If sunset review becomes just another forum for political disagreements that are not supported by evidence on either side, it is hard to imagine how it would be an improvement.

The last three administrations have attempted, with some success, to increase the supply of, and demand for, performance data that can be used for resource allocation and management. It is worth at least considering how we could move beyond a simple discussion of how much it COSTS to pursue particular policy alternatives to more explicitly considering the effects of these policies. In my view, the federal budget is pretty good at this point at telling us how much things cost, but pretty bad at telling us what the benefits are. This is, unfortunately, symptomatic of a larger problem afflicting the federal budget, which is that not nearly enough consideration is given to whether policies or programs work (as opposed to, say, in whose Congressional district the money gets spent). This seems a glaring omission in a \$4 trillion budget.

*Expedited Rescission*—Proposals to give a line item veto to the President have abounded since Ulysses S. Grant first proposed such a veto in the 1870s. In 1995, the Congress passed, and the President signed, the Line Item Veto Act, which was a legislative equivalent of a line item veto that was ultimately declared unconstitutional by the Supreme Court in 1997. Subsequently, Presidents Bush and Obama each proposed that he be granted a reduced form of line-item veto authority

through what is referred to as “expedited rescission.” Under this proposal, a president would be guaranteed a vote on rescission proposals that he proposed, and individual items would be subjected to an “up-or-down” vote on the Senate or House floor. The presumption is that these items would be subject to greater scrutiny, making it harder for the more egregious pork barrel projects to survive. In the 111<sup>th</sup> Congress, the expedited rescission approach is probably best exemplified by S. 102, sponsored by Senators Carper and McCain. There is nothing, in my view, particularly wrong with expedited rescission proposals. There is no particular reason that a President should not be able to obtain a vote on his proposed rescissions. I do think that, if proposals to ensure votes on Presidential proposals to reduce earmarks are going to be enacted, they should find a way to include targeted tax benefits as well as spending, as the Line Item Veto Act of 1995 did.

There are other proposals that have gotten less attention that I think represent useful areas of focus for the Congress. In particular, I think that reforms that force the Congress and the President to recognize the cost of individual policy choices will promote greater attention to policies that have costly future budgetary effects. That is, that if policymakers have to recognize the cost of their actions, it may encourage them to behave otherwise. There are a few examples of this:

- The Federal Credit Reform Act discouraged the notions that loan guarantees are costless and direct loans are like grants;
- The 1995 unfunded mandate legislation has discouraged the imposition of costly new mandates by forcing the Congress to at least consider their cost. Very few mandates have been enacted since this law took effect.
- The various scorekeeping rules agreed to after 1990 and codified in 1997 have reduced the level of budget chicanery. The lease-purchase rule, for example, has been used to explicitly recognize long-term acquisition costs (a good example of this was the Boeing tanker charade from the mid-2000s, which was eventually seen for the costly federal commitment that it was).

Issues like this (which are really about budget concepts and budgetary accounting) seem much more fruitful to focus on than larger fiscal rules, or even institutional reforms. There are lots of these issues that could be the focus of your discussion, but such as list would clearly include:

- What to do with the transactions of the GSEs now that we have, in practice, removed the word “sponsored” from their title.
- Whether there are other places where accrual concepts, such as used for credit programs, would send more appropriate signals to policymakers than the current cash treatment (such as deposit insurance, pension guarantees, flood insurance, or natural disaster policies).
- Whether changes should be made in the way that we budget for natural disasters and other “emergencies” (the tendency has been to underfund them in the regular appropriations process because we won’t be able to help ourselves later).

This is by no means a comprehensive list of possible reforms. These are certainly other examples that others might be able to identify. The important point is that these micro-level incentives are liable to have far greater payoff than larger fiscal rules that try to get us to balance the budget, or reduce entitlements, or achieve world peace, or any number of other lofty goals we might consider.

### Conclusion

The budget process is important. It allocates more than 20 percent of the goods and services produced in the U.S. economy. It can be good, in my view, at two things. The first is to force policymakers to confront the real costs of their actions, and to provide information that is necessary for them to make budget decisions. The

second is to enforce compliance with budget decisions that have already been made. Unfortunately, however, it is not very good at forcing the political system to deal with fiscal problems, if it lacks the political will to do so.

Much of the budget process infrastructure that is needed to deal with our current budget problems already exists today. The President, through his budget, can propose a comprehensive plan. The Congress, through the budget resolution and reconciliation, can enact legislation that will, on a multi-year basis, reduce the current debt and promote fiscally responsible actions in the future. I would urge the Congress to focus on developing the consensus, passing legislation to reduce the deficit, and enacting budget reforms that focus on micro-level budgetary incentives and budget enforcement procedures. This will have much greater payoff than getting sidetracked by establishing fiscal rules without enacting the necessary policy changes to meet those targets.

Thank you for the opportunity to share these views. I look forward to answering whatever questions you may have.