Testimony

Federal Budget Process Reforms

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* The opinions expressed herein are mine alone and do not represent the position of the American Action Forum. I thank Gordon Gray for his assistance.

INTRODUCTION

Chairman Enzi, Ranking Member Sanders and members of the Committee, I am pleased to have the opportunity to appear today. In this testimony, I wish to make a few basic points:

- The U.S. faces a dramatic threat from the current and projected levels of federal debt, driven by ever-increasing mandatory spending;
- The current Congressional budget process is broken, and does not facilitate addressing the threats to the Nation;
- A "fiscal rule" would be a valuable step toward budgetary practice that would address the debt threat and preclude its recurrence; and
- Budget process reforms are commendable, and to the extent they can precipitate action, they should be pursued, but are no substitute for necessary underlying policy changes.

Let me discuss each in turn.

THE THREAT FROM FEDERAL DEBT

The federal government faces a problematic budgetary future, largely due to long-term pension, health, and other spending promises coupled with recent programmatic expansions. The core, long-term issue has been outlined in successive versions of the Congressional Budget Office's (CBO's) *Long-Term Budget Outlook*[1]. In broad terms, the inexorable dynamics of current law will raise federal outlays from an historic norm of about 20 percent of Gross Domestic Product (GDP) to anywhere from 30 to nearly 40 percent of GDP. Any attempt to keep taxes at their post-war norm of about 18 percent of GDP will generate an unmanageable federal debt spiral.

This depiction of the federal budgetary future and its diagnosis and prescription has all remained unchanged for at least a decade. Despite this, lasting action (in the right direction) has yet to achieve the force of law.

In the past several years, the outlook has worsened significantly.

Over the next ten years, according to the Congressional Budget Office's (CBO's) analysis of the President's Budgetary Proposals for Fiscal Year 2016[2], the deficit will average nearly $600 billion over the next ten years. Ten years from now, in 2025, the deficit will be $800 billion.   As a result of the spending binge, in 2025 debt held by the public will have doubled from its pre-financial crisis level in 2007 to over 70 percent of GDP and will continue its upward trajectory.

The "Bad News" Future under Massive Debt Accumulation. A United States fiscal crisis is now a threatening reality. It wasn't always so, even though, as noted above, the Congressional Budget Office has long published a pessimistic *Long-Term Budget Outlook*. Despite these gloomy forecasts, nobody seemed to care. Bond markets were quiescent. Voters were indifferent. And politicians were positively in denial that the "spend now, worry later" era would ever end.

Those days have passed. The world has witnessed Greece, Italy, Portugal, Spain, Ireland, and even Britain under the scrutiny of skeptical financial markets. And there are signs that the U.S. is next – as witnessed by the decision of S&P to downgrade the federal credit rating.[3] By the end of the decade 80 cents out of every borrowed dollar will be spent just to pay off debt service, an outlook that underscores the nation's financial straits.

How did this happen? First, the U.S. frittered away its time for easier action. It was widely recognized that the crunch would only arrive when the baby boomers began to retire. Guess what? The very first official baby boomer already chose to retire early at age 62, and the number of retirees will rise as the time progresses. Crunch time has arrived and nothing was done in the interim to solve the basic spending problem – indeed the passage of the Medicare prescription drug bill in 2003 made it worse.

Second, the events of the financial crisis and recession used up the federal government's cushion. In 2007, debt outstanding was only 35 percent of GDP. It has since doubled.

Third, active steps continue to make the problem worse. The Affordable Care Act "reform" added new entitlement programs for insurance subsidies and more expansive Medicaid.

Financial markets no longer can comfort themselves with the fact that the United States has time and flexibility to get its fiscal act together. Time passed, wiggle room vanished, and many actions taken thus far have made matters worse.

As noted above, in 2025 public debt will have more than doubled from its 2007 level to over 70 percent of GDP and will continue its upward trajectory. Already, gross federal debt exceeds 100 percent of GDP.

Perhaps even more troubling, much of this borrowing comes from international lending sources, including sovereign lenders like China that do not share our core values. Notwithstanding geopolitical concerns, this indebtedness amounts to $94 billion in Treasury payments outside of U.S. borders a year.[4]

For Main Street America, the "bad news" version of any future fiscal crisis occurs when international lenders revolt over the outlook for debt and cut off U.S. access to international credit. In an eerie reprise of the recent financial crisis, the credit freeze would drag down business activity and household spending. The resulting deep recession would be exacerbated by the inability of the federal government's automatic stabilizers – unemployment insurance, lower taxes, etc. – to operate freely.

Worse, the crisis would arrive without the U.S. having fixed the fundamental problems. Getting spending under

control in a crisis will be much more painful than a thoughtful, pro-active approach. In a crisis, there will be a greater pressure to resort to damaging tax increases. The upshot will be a threat to the ability of the United States to bequeath to future generations a standard of living greater than experienced at the present.

Future generations will find their freedoms diminished as well. The ability of the United States to project its values around the globe is fundamentally dependent upon its large, robust economy. Its diminished state will have security repercussions, as will the need to negotiate with less-than-friendly international lenders.

The "Good News" Future under Massive Debt Accumulation. Some will argue that it is unrealistic to anticipate a cataclysmic financial market upheaval for the United States. Perhaps so. But an alternative future that simply skirts the major crisis would likely entail piecemeal revenue increases and spending cuts – just enough to keep an explosion from occurring. Under this "good news" version, the debt would continue to edge northward – perhaps at times slowed by modest and ineffectual "reforms" – and borrowing costs in the United States would remain elevated and escalating.

Profitable innovation and investment will flow elsewhere in the global economy. As U.S. productivity growth suffers, wage growth stagnates, and standards of living stall. The combination of sluggish income growth and a very large tax burden from the debt, assures that the next generation will inherit a standard of living inferior to that bequeathed to this one.

THE NEED FOR ACTION

The federal budget problem demands fundamental reforms to major mandatory spending programs – Medicare, Medicaid, Social Security, the Affordable Care Act – and would benefit from the improved growth derived from fundamental tax reform. Despite this, successive budget proposals by the president are devoid of reform proposals and characterized at best by the type of piecemeal spending cuts and tax increases that invite stagnation.

The passage of the Budget Control Act of 2011, its caps on discretionary spending, and the formation of the Joint Select Committee on Deficit Reduction represented a commitment to move the nation's finances in a better direction.

However, the failure of the Committee to report recommendations to address our fiscal challenges has left the United States in a perilous position. Since the Committee's failure, we have seen exactly the type of piecemeal reforms that are inadequate to our fiscal challenge: anti-growth tax rate increases and poorly targeted discretionary spending cuts that harm military readiness.

However, the structural budget challenges the nation faces are so pressing and significant that they outweigh in terms of their implications for economic output even a near-term recession. Clearly something must be done to avoid a downturn, but any such undertaking must be paired with reforms to address our fiscal imbalance.

THE BROKEN BUDGET PROCESS

The Congressional budget process is broken and does not engender regular evaluation of the fiscal health of the federal government. Indeed, the *prima facie* evidence of its failure is that fact that the president has regularly submitted budgets that clearly display a path to a sovereign debt crisis, the U.S. Senate completed the budget

process prescribed in law this year after a 6-year hiatus, while the Congress as a whole regularly operates without a binding budget resolution – all with no consequence.

The budget process is intended to facilitate a regular and disciplined evaluation of the inflow of taxpayer resources and outflow of federal spending. It should enhance the role of the Congress as a good steward of the federal credit rating. It does neither because the current process is insufficiently binding. As a result, it easily degenerates to the mere adoption of current-year discretionary spending levels, with no review of the real problem: the long-term commitments in mandatory spending.

THE VALUE OF FISCAL RULES

At present, the federal government does not have a fiscal "policy." Instead, it has fiscal "outcomes". The House and Senate do not reliably agree on a budget resolution, and when they do, the executive branch does not necessarily concur. Annual appropriations reflect the contemporaneous politics of conference committee compromise, and White House negotiation. Often, the annual appropriations process is in whole or part replaced with a continuing resolution. Annual discretionary spending is not coordinated in any way with the outlays from mandatory spending programs operating on autopilot. And nothing annually constrains overall spending to have *any* relationship to the fees and tax receipts flowing into the U.S. Treasury. The fiscal outcome is whatever it turns out to be – usually bad – and certainly not a policy choice.

I believe that it would be tremendously valuable for the federal government to adopt a fiscal rule. Such a rule could take the form of an overall cap on federal spending (perhaps as a share of gross domestic product (GDP)), a limit on the ratio of federal debt in the hands of the public relative to GDP, a balanced budget requirement, or many others. Committing to a fiscal rule would force the current, disjointed appropriations, mandatory spending, and tax decisions to fit coherently within the adopted fiscal rule. Accordingly, it would force lawmakers to make tough tradeoffs, especially across categories of spending.

Most importantly, it would give Congress a way to say "no." Spending proposals would not simply have to be good ideas. They would have to be *good enough* to merit cutting other spending programs or using taxes to dragoon resources from the private sector. Congress would more easily be able to say, "not good enough, sorry."

As documented by the Pew-Peterson Commission on Budget Reform other countries have benefitted from adopting fiscal rules. [5] The Dutch government established separate caps on expenditures for health care, social security and the labor market. There are also sub-caps within the core sectors.

Sweden reacted to a recession and fiscal crisis by adopting an expenditure ceiling and a target for the overall government surplus (averaged over the business cycle). Later (in 2000) a balanced budget requirement was introduced for local governments. Finally, in 2003 the public supported a constitutional amendment to limit annual federal government spending to avoid perennial deficits.

A lesson is that, no matter which rule is adopted, it will rise or fall based on political will to institute it and the public's support for its consequences.

NECESSARY POLITICAL WILL

Process reform, no matter how well intentioned or considered is no substitute for the actual reforms needed to address the looming debt crisis fueled by federal spending. No statutory spending cap or sequester can replace the needed debate on what a realistic or fair retirement age should be, or what the proper federal role in seniors' health care delivery is. So while I commend any meaningful improvement to process reform, I would also caution this Committee's membership, as many know, the clock is ticking on the need for that broader discussion.

Thank you. I look forward to your questions.

[1] Congressional Budget Office. 2015. *The Long-Term Budget Outlook.* Pub. No. 50250. https://www.cbo.gov/publication/50250