Backgrounder

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Four Principles of Budget Process Reform

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Restraining runaway federal spending will require difficult decisions by lawmakers. Lawmakers who are willing to take a tough stand need a budget process that helps, rather than hinders them, and that is not stacked in favor of excessive spending.

Unfortunately, Congress remains saddled with an outdated budget process that was created in 1974—when the federal budget was only one-third of its current size. A 30-year-old budget process that has been punched full of holes by successive Congresses cannot adequately address the nation's current budgetary challenges.

Lawmakers are working to repair the federal budget process. Yet, budget process reform can easily become bogged down in technicalities, obscuring the big picture. Any positive budget reforms should reflect four general principles:

Principle #1: Overall Spending Should Be Capped at a Set Level

Families understand spending caps. Every year, millions of families sit down at their kitchen tables and evaluate how much they can afford to spend. A family's wish list almost always exceeds what it can afford; therefore, the family must prioritize in order to remain underneath the cap. Setting limits is never easy: However, responsible budgeting keeps these families solvent in the long run.

The federal government does not cap spending. Lawmakers can simply add up the cost of their preferred programs and pass legislation to fund them. Mandatory programs—which now comprise two-thirds of all federal spending—grow each year without any cap or oversight. Discretionary programs grow with only slight constraints

Talking Points

- The current 30-year-old budget process cannot adequately address runaway federal spending because it is designed to maximize spending.
- Enforcing the difficult decisions needed to restrain spending will require real caps on both discretionary and mandatory spending.
- Washington needs to begin accounting for its future liabilities and match promised benefits with realistic means to fund them.
- Bringing the President into the budget resolution process will settle contentious debates early and provide real enforcement of spending limits.
- In order to restrain spending, Congress needs to close the loopholes that riddle the current budget restraints.

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imposed by the annual budget resolutions. Without real federal spending caps, lawmakers often avoid difficult trade-offs and spending grows beyond what taxpayers can afford. Not surprisingly, mandatory spending is growing 7 percent annually. Abandoning enforced caps on discretionary spending has resulted in double-digit growth in annual discretionary spending.

There are several options available to cap spending. Multi-year caps on discretionary spending succeeded in the 1990s, when they were enforced and considered politically realistic. Lawmakers could set annual spending cap levels every few years or determine them by a formula, such as inflation plus population growth. Linking spending increases to budget deficits or to the gross domestic product is more difficult because economic growth and tax revenues can fluctuate rapidly. Additionally, those limits would require the deepest spending cuts during recessions and allow large spending hikes during booms.

Caps could work for mandatory programs as well. In the 1990s, these programs were subjected to PAYGO rules that limited only the creation of new entitlements—and did nothing to limit the calamitous spending increases projected in the current Social Security and Medicare baselines. With mandatory spending projected to double in 10 years and overwhelm the rest of the budget, current mandatory programs can no longer be left off the table. Effective caps should apply to all federal spending—whether mandatory or discretionary, current or proposed.

Lawmakers could create separate levels for mandatory and discretionary spending, utilizing distinct levels or growth formulas.[1] Alternatively, they could set a single "omnicap" that applies to all federal spending. An omnicap would have the advantage of allowing trade-offs between mandatory and discretionary spending—thus promoting flexibility and simplicity.

Principle #2: The Annual Budget Should Present a Full Picture of Future Obligations

Families also understand the costs of long-term financial commitments. They can quickly calculate how much they owe on their mortgage, car, and other long-term obligations, and when those obligations will be fully paid. Importantly, families cannot commit to new financial obligations without demonstrating that they can pay for them. For example, potential homeowners must make a substantial down payment and show that they can afford the monthly payments.

Businesses operate under similar fiscal constraints. A business is required to disclose the size and scope of its obligations on financial statements so that shareholders, oversight entities, and potential investors can understand the true nature of its financial condition and can make informed decisions. It must report all long-term obligations, including liabilities associated with pension and retirement health care plans—similar in nature to Social Security and Medicare—while a measure of their growth is counted against the business's bottom line.

While measuring these types of liabilities is much more difficult than reporting the liability on a contract or mortgage, excluding this information from financial reports can grossly misrepresent a business's financial viability and lead to poor decisions by management and boards. Including the best estimate of such liabilities—and their annual impact on the bottom line—is superior to implying that no obligation exists by excluding such calculations because they are imprecise and difficult to estimate.[2] In this way, every business is required to pay *today* in order to fulfill its obligations for *tomorrow.*

The federal government is under no such constraints. The federal budget does not include any measure of the federal government's future obligations and thus misinforms citizens about the true fiscal burden facing the nation. This omission allows policymakers to ignore the need for fiscal planning and reforms. Lawmakers can commit to a massive financial entitlement (such as the Medicare drug benefit) with no down payment, no set monthly payments, and no standard "credit check" to determine which commitments are affordable. The entire open-ended spending spree is placed on a credit

1. Lawmakers could create a commission to propose options for resolving overruns in projected mandatory spending and to require an unamended, up-or-down vote on each option.
2. Financial Accounting Standards Board, "Employers' Accounting for Postretirement Benefits Other Than Pensions," *Statement of Financial Accounting Standards* No. 106, December 1990, p. 5, at *www.fasb.org/pdf/fas106.pdf* (April 5, 2004).

card with no spending limit, relying on blind faith—rather than annual planning—that future generations will pay the balance.

A positive first step would be to include a measure of all future obligations in the federal budget, just as businesses are required to do. This would contain a breakdown of contractual liabilities, such as debt, and social insurance liabilities, such as Medicare and Social Security. If budgets began including these measures, policymakers would no longer be able to ignore these liabilities and could begin budgeting for their costs and initiate the reforms necessary to keep these financial commitments manageable.

Principle #3: The President Should Be Involved Throughout the Budget Process

If two parties are expected to negotiate a detailed agreement on a complex subject within a nine-month period, separating them until the end of the ninth month makes little sense. It makes even less sense for one side to spend a great deal of time working out the smallest details of its offer without first having forged the basic structure of an agreement with the other side. Yet, Congress and the President currently use this method to write the federal budget.

The President begins the process in February by presenting his proposed budget as an opening offer. Congress then spends up to eight months preparing its counteroffer in the form of 13 detailed, annual appropriations bills. At that point—with the deadline for completion quickly approaching—the President's options are limited to either signing or vetoing each appropriations bill.

Without any agreed-upon budgetary framework, these last-minute negotiations over the details of hundreds of programs become extremely difficult. The inevitable results are rushed compromises that are completed well past the fiscal year deadline. In fact, the past two federal budgets were completed four months late—one-third into the year that they were designed to fund.

An increasingly popular solution would be to move from a concurrent budget resolution (which does not involve the President) to a joint budget resolution (which would be signed into law by the President). By working out differences early in the process and enacting a binding law, contentious debates on the size of government would be settled in March—rather than in October, when delays risk government shutdowns. The appropriations debate would be limited to the composition of federal spending, and disagreements would be far easier to resolve if spending limits were already fixed by law.

Issues remain regarding how to move the budget process forward when Congress and the President are unable to agree on a budget blueprint. One idea is to require a supermajority to pass spending bills that are introduced under an unsigned budget resolution. That would provide adequate pressure on Congress and the White House to settle their differences.

Another way to bring the President into the process would be to require congressional votes to block rescissions. Presidential rescission requests, which cancel previously appropriated budget authority, currently require both House and Senate approval to take effect. Thus, Congress can block a rescission by simply refusing to vote on it. Requiring Members of Congress to vote down the rescissions they oppose would be a positive reform. Rescission proposals not voted down by at least one house of Congress within 45 days would go forward. Supporters of questionable spending could no longer avoid going on the public record with their position.

Principle #4: Budget Decisions Should Include Strong Enforcement.

Budget restraints without strong enforcement are paper tigers. Restraints are intended to force Congress to make some uncomfortable trade-offs in order to preserve the nation's long-term economic health. However, Members of Congress typically take the easy path of seeking loopholes that bypass restraints, thus avoiding difficult choices. Consequently, rules are only strong as their weakest link.

For example, the discretionary spending caps of the 1990s did not apply to emergency spending. Predictably, lawmakers began classifying regular annual spending as "emergency" spending in order to bypass the caps. Congress should budget sufficiently for regular "emergencies" while assuring that the necessary escape hatch for unforeseen, catastrophic emergencies is not abused. Modest reform options include altering the definition of emergency spending and requiring the President to agree to an emer-

gency designation. A more ambitious reform would require lawmakers to set aside a pre-determined portion of the budget for emergencies and require a supermajority vote to spend beyond that fund.

The budget resolution's spending ceilings are also weakly enforced. In the House of Representatives, passing a spending bill that exceeds the spending ceiling requires only a simple majority—which is no more of a hurdle than any other spending bill must clear. This renders the budget resolution's spending ceilings meaningless in the House of Representatives. The Senate is slightly better, requiring a three-fifths vote to violate the budget resolution.[3] Real enforcement, however, may require closer to a two-thirds vote. Furthermore, if lawmakers convert the concurrent budget resolution into a joint budget resolution, exceeding spending limits would also require White House approval.

Such reforms would promote better planning and coordination within the constraints of the budget caps and annual budget resolution.

Conclusion

The federal government currently spends over $20,000 per household. That cost is projected to begin rising sharply over the next 10 years, when retiring baby boomers begin receiving Social Security and Medicare benefits. Lawmakers can avert painful tax increases only if they make the difficult decision to limit federal spending. The current budget process, which is designed to maximize federal spending, is the wrong tool for that job. The four principles listed above represent positive budget reform consistent with sound planning, responsible spending, and low taxes.

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3. A three-fifths vote in the Senate is required only if a Senator raises a point of order against legislation violating the rule. Otherwise, a simple majority vote of the Senate could override the budget resolution's spending levels.