It's Time for A Second Commission on Budget Concepts

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Given my "just outside the beltway" perspective, the title of this conference presents a scary projection: "The Budget Act: The Next 30 Years." The budgetary record of the past three decades has not been impressive. In most years since 1974, deficits have been too large. Yes, from 1990 through 1997 the federal government exhibited such control that the aggregates were moved, with the help of impressive economic growth, from large deficits to large surpluses. But those surpluses soon became politically unsustainable, and the nation is now on a long-term fiscal course that invites economic disaster. Just imagine putting current policy into a computer from 1974–remember, budget analysts didn't have personal computers or spreadsheets then. The answer would certainly be "does not compute"–but not because of the obsolescent computer. Instead, the problem is simply that too many people imagine that an ever-growing government can be financed by a tax take that is at a historically-low percent of GDP.

Defenders of the Budget Act often say that without it, things would be worse. Perhaps, but how much worse can they get? Important deadlines are missed routinely, and partisanship over budgets is excessive. Compared to the first years of the Act's implementation, when there was a good faith effort to debate priorities, the functional allocations in the budget resolution are now symbolic–that is, when the budget resolution is adopted. There is too much inefficient spending, and the tax code is horrendously complicated by seemingly innumerable tax preferences. Finally, the public has little understanding of budgets–but given the other problems, perhaps that's a blessing.

So I would have been happier with a conference title along the lines of "Imminent Reforms to the Budget Act." But my criticism is tempered by one clear success–improving the quality of budgetary information. This success has not been unqualified. Yet there is no question that the budgetary information now available to elected officials and the public–cost estimates, annual reports, budget updates, and so on–is usually of very high quality. For that, much credit is deserved by the institutions created by the Act–the Congressional Budget Office, and the Senate and House Budget Committees.

Why and how has the Act improved the quality of budgetary information? Competition, in part. In 1974, legislators understandably questioned statements by the President's budget office, so they decided to create their own group of experts. Today, in countries across the world where they usually have much greater reasons to distrust executives, the U.S. Congress is greatly envied for having such a professional and impartial support agency. That success is due to many factors, which I look forward to learning about in Phil Joyce's planned book. But some are already well known, including that CBO has had smart, tough, and visionary leaders and a top notch staff. A core organizational goal has been to communicate as clearly as possible. And unlike in many of those envious countries, a competitive party system and assertive legislators have provided CBO with a demanding client that pushes the agency to excel. (Before my friends at GAO get upset, I want to state for the record that GAO has long provided a related check on the executive, and that GAO's recent work on budget issues has been excellent.)

While competition from CBO has reduced OMB's temptation to cook the books, we should also credit the substantial cooperation between these organizations. Most budget staff value financial prudence and technical efficiency. Adding CBO to OMB increased the critical mass of budget experts, and the staffs have worked together to develop substantial advances in budgetary information, most notably with credit reform.

Turning to the House and Senate Budget Committees, they too have helped improve budgetary information. Both committees have important political roles to play, which has included reducing budget information quality through directed scoring. Yet the committees have been useful competitors to committees that have narrower perspectives, and have usually been chaired by first-class public servants like Senator Domenici and Representative Panetta. Budget committee staff have helped clarify budgetary choices–a perfect example is the Senate Budget Bulletin, which is required reading for people who want to understand what really is going on.

Having praised these institutions, I now want to bury the idea that budgetary information always supports good decisionmaking. I'll start with an example from the Senate Budget Bulletin of August 23, 2004, which sets out the committee's position on scoring issues related to the Military Housing Privatization Initiative (MHPI). To make a long story very short, advocates of construction for military housing, because they are dissatisfied with the resources granted in regular appropriations bills, have developed an alternative method of financing construction. This method relies on sham private ownership to entice budget scorekeepers to count only a small part of the program's costs upfront in the budget. In this case, OMB has taken the bait. CBO has not, insisting that the full costs be shown when the funds that eventually will pay for construction and financing are first obligated. CBO notes that the projected cost of the MHPI includes one premium for private rather than Treasury financing and a second for the more complicated structure of the properties' ownership and management.

What is going on here? On the one hand, inevitable budgetary gamesmanship. In some of my research, I've documented that sophisticated spending advocates who want more resources than received through incremental bargaining turn to approaches that seek to exploit problems with budgetary rules. Budget agencies, budget committees, and the Treasury Department usually try to prevent these techniques. But they can never be completely successful, because budgeting is unavoidably complicated and unavoidably political. In particular, budget concepts are inherently challenged when policies involve long time periods, uncertainty about the extent of government commitments, involvement by the private sector, and the use of tools like tax preferences and regulations.

On the other hand, I believe that the U.S. government has not tried hard enough to cope with these complications. Certainly the debate on the Congressional Budget Act skated over them–Congress was understandably more concerned about committee jurisdictions, legislative procedures, and its relationship with the President. Since then the Budget Act has been amended repeatedly, and often with reference to budgetary accounting and scorekeeping. In many of these cases, the amendments temporarily resolved political conflicts or ratified useful agreements between budget agencies and committees. Looking at the history, however, it is easy to remember some nonsense–such as the law requiring that Social Security be considered to be "off-budget." More generally, this process did not ensure that accounting and scorekeeping rules force accurate descriptions of the government's finances.

Some who have mastered the complexity of the current system disagree with that assertion. I would like to pose two questions to them. First, do you not agree that there are numerous examples where intelligent people–including many of the nation's leading fiscal experts--believe that the current budget system is misleading? And second, given these concerns, should not we systematically review the purposes of the budget and the practices that would be most likely to support these purposes?

Here are some examples related to that first question--a short list of current budget accounting and scorekeeping practices that have been widely criticized:

1. Crediting revenues to Social Security and Medicare without booking the matching obligations that they imply for the future. (And if you don't think this is a problem, how can the accrual accounting used by some other long-lived entitlement programs be justified?)

2. Ignoring the large implicit subsidies and related financial risks presented by government sponsored-enterprises, most notably Fannie Mae and Freddie Mac. (Would not this problem be resolved by now except for the extraordinary political influence of these organizations?)

3. Underestimating the likely long-term costs of government insurance commitments. (If you are certain that the problems created by offering moral-hazard-favoring deposit insurance and then failing to resolve losses quickly can not be replicated in other insurance programs, have you looked at the Pension Benefit Guaranty Corporation's books?)

4. Underreporting the costs of acquiring assets or the services they deliver, and overreporting revenues from selling those assets. (Is everything in the Boeing tanker deal proper?)

5. Assuming that discretionary spending will expand at a rate far lower than historical averages, absent a procedure for ensuring this result. (Is it really impossible to project within a sensible range the likely costs of operating in Iraq during fiscal year 2005?)

6. Using long horizons for scorekeeping to offset current costs with unrealistic future savings. (Is my tax advisor correct that I should die in 2010 rather than in 2011 for my children's sake?)

7. Failing to highlight the costs of the many tax preferences that are functionally equivalent to spending. (Wouldn't it make sense to dismiss with a laugh ideas like Qualified Zone Academy Bonds?)

Now it is possible that all of these concerns are overdone; that the organic evolution of budget rules has produced a workable, sensible system. But if that is the case, I wonder why the government's annual financial report is not credible despite two decades of hard work by many accountants and large investments in financial information systems. For in recent testimony, the Comptroller General stated:

> "Current financial reporting does not clearly and transparently show the wide range of responsibilities, programs, and activities that may either obligate the federal government to future spending or create an expectation for such spending and provides an unrealistic and even misleading picture of the federal government's overall performance and financial condition."[1]

Prior to enactment of the Congressional Budget Act, the 1967 President's Commission on Budget Concepts addressed a similar perception about the inadequacies of federal budget accounting. Its main recommendation and greatest legacy was that decision-makers should take a comprehensive view of the government's finances. I strongly believe that it is time for another

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[1] David M. Walker, "Fiscal Year 2003 U.S. Government Financial Statements: Sustained Improvement in Federal Financial Management is Crucial to Addressing Our National's Future Fiscal Challenges," Testimony before the Subcommittee on Financial Management, the Budget and International Security, Committee on Governmental Affairs, U.S. Senate, July 8, 2004.

Budget Commission–one that would be transparent to the public, open-minded about alternative perspectives, and systematic in its review of all major issues.

Commissions are not a magic solution–whether the intent is to actually address problems or to temporize in hopes that they will go away. Frankly, I think the latter approach is not an option, because the fiscal course of the U.S. is now toward some very turbulent waters. When elected officials decide to improve their navigation, a commission could provide the kind of assistance that tugboats necessarily provide to supertankers. After all, there are many public finance experts in this country who have thought long and hard about the issues that should trouble us. We can't expect experts to agree on everything, but I do think that high-level exchanges between them would produce some useful recommendations. A similar process was one of the reasons why the 1967 Commission's work was influential. (The existing Federal Accounting Standards Advisory Board's main function has been to assist agency government accountants. The Board has not had sufficient visibility and participation by experts and stakeholders to resolve other problems–intentional disabilities, as the Memorandum of Understanding that created it excluded budget concepts from its jurisdiction.)

A commission could also help the U.S. broaden its perspective beyond its borders. While our system of government is quite different from most others, particularly in its empowerment of the legislature, the essential challenges of budgeting are similar in all countries. Arguably other countries–and not just rich ones--have developed practices that we might emulate, and a commission might help us learn more about such practices.

Much of a budget commission's agenda is suggested by criticisms of the current process, and no one should minimize the difficulty of resolving these issues. I'll conclude, however, by piling on another ambition. We humans tend to fight the last war. When I fly out of the Baltimore airport, I often see old ladies in wheelchairs being scanned for suicide bombs, but when I drive past the port, I see many cargo containers with who knows what is in them. I would hope that a commission would fight this tendency. Not only should it try to prevent end runs around current budget concepts, it should also think more broadly about the purposes and practices of budgeting. Here are four suggestions for that agenda.

First, the current budget process greatly emphasizes point estimates over range estimates, and to a large degree, this approach is unavoidable. To compensate, budget agencies have long illustrated uncertainties with their rules of thumb for macroeconomic assumptions. CBO in particular should be commended for its recent work that uses simulations and visual displays to show the sensitivity of major policies to critical variables. These practices can help minimize surprises, which is especially important because so much of the budget is uncontrollable over the short-term.

But remember that the Congressional Budget Act was adopted in part because legislators recognized there had been a worrisome increase in mandatory spending over the decade that preceded the Act. The Act's controls on mandatory spending have not prevented the budget from becoming even more inflexible, including through the expanded use of tax preferences. So though budget experts should be encouraged to further improve their abilities to model uncertainties associated with uncontrollable policies, that will not be sufficient to deal with our upcoming budgetary challenges. We must also find ways to manage actively budgetary risks and opportunities. A budget commission could help with that by investigating how to design spending and tax policies to be more flexible.

Second, budgeting in the U.S. has long been fixated with the "bottom line" of the deficit. The 1967 Budget Concepts Commission argued that this single measure was a useful guide for a multitude of policy goals, but their logic should no longer be convincing. Speaking about fighting the past war, let's consider the current one. Do any of you believe that the only budgetary measure for our operations in Iraq should be the total of bills just paid by the Department of Defense? Should not the resource cost of operations also count, such as through the effect of depreciation on hardware replacement needs, or perhaps even including the long-term effect from stop-loss orders and similar personnel policies on future recruiting and retention spending? In other words, a budget commission should seriously explore how the government could use multiple bases of accounting for budgeting.

Third, another take on the value of using different perspectives is that we overemphasize budgeting and underemphasize broader processes of policy-making. Again, just as it makes sense to use point estimates, there are good reasons to focus on the government's finances. But in some areas of policy-making, this focus can be too narrow–an argument that was made by Herb Stein in his 1989 book Governing the $5 Trillion Economy. Now that the economy is twice that size, we should return to thinking about some of his arguments.

For an example, consider health spending. Around when Stein wrote his book, reconciliation bills generated savings for Medicare and Medicaid. They did so in part by encouraging cost-shifting to private insurers. Even today, there are disagreements about whether doing so increased or decreased the efficiency of the health sector of our society. I won't try to resolve that question, but rather will point out that it is very desirable to seek ways to improve the efficiency of the health care sector–after all, demographics and technological innovation assure us that the percentages of GDP and of the federal budget devoted to health will explode over future decades.

A decade ago, CBO was caught in a difficult position when it had to advise the Congress about whether proposed "health care alliances" should be on-budget or off-budget. CBO leaned towards the former because it understands the value of taking a comprehensive view, as currently captured by the concept of the unified budget. I believe this comprehensive approach to budgeting could be helpfully supplemented by other and even wider comprehensive views. For example, health budgeting could be informed by periodic reviews of the health sector, in which spending and tax policies could be connected to regulatory policy, torts policy, patents policy, and federalism policy. Through the IMF and the World Bank, the U.S. government currently requires such analyses in selected poor countries. If we indirectly mandate this approach elsewhere, at the very least a budget commission could explore how it could work at home.

Finally, there is a great irony about the concern that budgetary accounting may not accurately measure costs. A general must be concerned about his casualties, but also be informed about his enemy's body count. In the budgeting context, the equivalent concept to that body count are the outputs and outcomes from spending. Since the adoption of the Government Performance and Results Act of 1993, the government has made much progress in developing performance measures, and the Bush Administration's Program Assessment Rating Tool provides a useful framework for linking program evaluations to budget decisions. However, the scope of this work is still too limited, particularly regarding tax preferences, and in many budget allocations, program information appears to matter little if at all. A commission could explore how output and outcome information could be more fully integrated into budgeting. I particularly think that this integration would be enabled if the government were to annually precede the budget resolution debate with a review of how the country is faring on a variety of important economic, social, environmental and national security indicators.

I'd like to thank Director Holtz-Eakin for the invitation, and I welcome your comments and criticisms.