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Testimony on H.R. 3929 and Other Budgetary Matters

Statement of
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Before the
Subcommittee on the Legislative Process
Committee on Rules
House of Representatives

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Mr. Chairman and Members of the Subcommittee:

I am pleased to have this opportunity to present our views on H.R. 3929, entitled the "Budget Process Reform Act of 1990," and on other matters concerning the budget.

The budgetary problems facing the Congress and the American people are so different and so much more complex than they were a few years ago that a reexamination of established concepts and procedures is required. Current practices are not successfully resolving these problems.

The problem centers on the huge deficits in the federal funds portion of the budget that developed in the 1980s as a by-product of conflicting policies that were not resolved in the budget process. Taxes were cut and government spending was increased and those actions were not reconciled. The situation continues today. Instead of dealing with the real issues through the political process, we resorted to formula budgeting--the Gramm-Rudman-Hollings (GRH) process--and discovered that doesn't work very well, either.

If current trends continue, the public debt will reach $4 trillion by the mid-1990s, consuming $250 billion to $300 billion per year of the nation's scarce supply of savings that should be flowing into productive capital investment. This represents an enormous threat to the nation's future economic growth and international competitiveness.

In the narrower context of managing the federal budget, this growth of debt means that interest costs consume a growing share of available general revenues. By the mid-1990s, interest could well become the largest single item in the federal funds portion of the budget. Meanwhile, a growing list of needs goes unmet and problems go unresolved. The deficit constrains our ability to respond to domestic problems, such as cleaning up toxic waste and repairing deteriorating roads and bridges. And it limits our ability to advance our national interests abroad, such as in responding to developments in Eastern Europe.

Budget Director Darman acknowledged some of these issues in his introductory essay in the 1991 budget, when he talked about the "hidden PACMEN" waiting to consume billions for the government's liabilities and unmet needs. But the budget itself makes only a very small down payment on these problems. For example, of the hundreds of billions needed to resolve the bankruptcy of the savings and loan insurance fund, less than $20 billion has been reflected in the budget.

REFORMS NEEDED IN CURRENT BUDGETING PRACTICES

It is clear that the country faces critical fiscal issues requiring far-reaching decisions by the federal government. To make those decisions wisely, policy makers need reliable and complete information presented in an understandable format that focuses on the key issues. And they need a process that encourages conscientious negotiation in the search for agreement that serves the national interest. Unfortunately, current practices do not satisfy these needs.

Structural Problems

There are major structural problems in the current unified budget with its exclusive focus on a single, cash surplus or deficit total. By merging growing trust fund surpluses (of which Social Security is the largest) with general operating amounts, it gives the illusion that progress has been made in reducing the deficit. The discouraging reality is that the deficit in general operations is larger today ($276 billion) than when we began the GRH process ($266 billion). (See attachment I)

Also, the budget's failure to highlight the investment and enterprise activities of the government, coupled with the inherent limitations of a cash-based budget, creates a bias against needed capital investment and an incentive to move enterprise operations such as the $40 billion per year Postal Service off budget.

Our concern about these problems has led us to propose[1] a restructuring of the budget into general, trust, and enterprise sections, with each divided into operating and capital parts. (See attachment II)

Understatement of Costs

Furthermore, the budget's almost exclusive focus on cash transactions means that many costs are greatly understated, a few are overstated, and others are totally ignored. For example, the exposure to possible losses on federal credit and insurance programs now stands at almost $6 trillion. The current presentation of the budget does not give proper visibility to this exposure and its budgetary consequences, nor does it encourage appropriate action to control the exposure. While the government will probably experience losses on only a small portion of this total exposure, the risk of very substantial losses is real, as we saw when the government's savings and loan deposit insurance commitments suddenly turned into a major fiscal problem with the bankruptcy of the Federal Savings and Loan Insurance Corporation (FSLIC).

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[1] Managing the Cost of Government: Proposals for Reforming Federal Budgeting Practices (GAO/AFMD-90-1/October 1989).

When GAO recently testified on its audit of FSLIC's final financial statements, we reported that at least $325 billion would be needed to pay off FSLIC's obligations, much of which will have to come from the U.S. Treasury. And the $325 billion could easily go to $400 billion, or even to half a trillion if the economy turns against us. There is still no reliable information on how these costs will affect the budget. To date, less than $20 billion has been included in the budget estimates.

Closely related to this problem, but on a smaller scale, is the practice of treating new loan guarantees as cost-free because they involve no cash outlays in the first year. But this is deceptive. During fiscal years 1983 to 1989, guaranteed loan terminations for default increased sharply, from about $5 billion to about $11 billion.

GAO believes the government should provide timely, on-budget funding for deposit and other insurance programs when it determines that insurance fees and premiums are insufficient to cover expected losses. We should also fund other major costs as the liabilities are incurred, such as the costs of the federal retirement systems.

The budget also needs a better focus on major unmet needs. It is encouraging that Budget Director Darman took a step in this direction with his "hidden PACMEN" discussion in the 1991 budget. We hope that this kind of presentation will become a permanent feature of the budget and that it will be strengthened and systematized. For Congress and the public to understand the implications of these issues, it needs at least rough estimates of costs, an indication of the timeframe in which action will be needed, and suggestions of how the costs will be reflected in future budgets.

A Formula Budget Process that Does Not Work Well

The third problem area in budgeting is the GRH process itself. In our November 1989 report on GRH procedures,[2] we noted that the act's focus on annual cash deficit targets encourages short-term "fixes" with too little consideration given to real, long-term solutions. For example, slipping pay days from the end of one fiscal year to the beginning of another is a savings illusion. Similarly, asset sales produce an immediate cash infusion and help reduce the short-term deficit, but sometimes at the price of increasing by an even bigger amount the long-term deficit. Moving $30 billion in borrowings for the savings and loan rescue effort to an off-budget Resolution Funding Corporation adds about $3 billion to Treasury interest costs over the long-run.

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[2] Deficit Reductions for Fiscal Year 1990: Compliance with the Balanced Budget and Emergency Deficit Control Act of 1985 (GAO/AFMD-90-40, November 15, 1989).

We also noted that the GRH process does not address the growing deficit in the nontrust fund side of the budget where the long-term problem lies, and the fact that the act's unusual budget accounting requirements contribute to unrealistic deficit projections.

I should also mention that GRH's mechanistic approach basically treats all nonexempt programs alike in the sequestration formula, regardless of their relative needs or effectiveness. More importantly, I sense that formula budgeting somehow weakens the legislative process and long-term public confidence in the government. Surely, government accountability is lessened and public confusion increased when 4 years of technical compliance with GRH provisions has not resulted in deficit reduction in the general operations of the government.

This is why we think that a different approach to budgeting is needed, one that builds upon the successful experience of the 1987 budget summit agreement, which produced a 2-year, bipartisan agreement on macro budget categories. If such an approach could be regularized, progress could be achieved in streamlining the process, extending the time horizon, and minimizing uneconomical decisions. It is through a bipartisan discussion of the budget deficit and its causes, a discussion that takes into account commitments and unmet needs, that the deficit problem will be properly addressed.

THE FEATURES OF H.R. 3929

Now let me turn to H.R. 3929. As you know, the bill would repeal the GRH law and substitute a new deficit reduction approach termed "pay-as-you-go." Instead of having statutory deficit targets (as in GRH), OMB and the Congressional Budget Office (CBO) would be required to calculate new deficit targets each year using the bill's pay-as-you-go formula. Essentially, the targets would be the difference between (1) baseline revenues and (2) baseline outlays minus inflation.[3] These targets would be further reduced by $10 billion in the first three budget cycles under the law.

Under the provisions of H.R. 3929, the off-budget Social Security surpluses would, unlike under the GRH law, not be included in the computation of the deficit.

The bill's approach is similar to the "outlay freeze" approach which attempts to hold outlay growth below inflationary rates. This allows revenues to "catch up" over time and reduce the deficit. However, H.R. 3929 does not require an inflexible outlay freeze because it contains a provision allowing outlay increases to be offset by revenue increases from new legislation.

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[3]Baseline amounts basically are projections assuming continuation of present law and adjustments for inflation and entitlements caseload.

H.R. 3929 contains no sequestration procedure (as in GRH) to enforce the required cutbacks. Instead, it would rely upon the legislative process to enforce adherence to the deficit targets. To improve congressional budgetary discipline, H.R. 3929 contains provisions designed to make it more difficult for bill sponsors to pass legislation increasing spending or decreasing revenues from the levels approved in the budget resolutions.

Positive Features of H.R. 3929

We see certain strong points in H.R. 3929, principally the following:

-- The repeal of GRH would reduce somewhat the formula aspects of current budgeting practices. More accountability for budgetary results would be placed back in the hands of Congress and the President.

-- By excluding Social Security from the pay-as-you-go formula, the bill comes closer to dealing with the federal funds deficit.

-- A required 5-year reconciliation feature would extend the time horizon of budgeting, reducing the incentives to adopt measures that produce short-term cash benefits but higher long-term costs.

-- New points-of-order would make it more difficult for bill sponsors to avoid the fiscal restraints of the budget resolutions, such as a point-of-order against certain bills to exclude a new or existing federal entity from the budget.

-- Restrictions on slipping pay days and using special asset sales to report budget savings for a fiscal year would eliminate or minimize these budgetary gimmicks.

-- H.R. 3929's definitions of certain budgeting terms (such as "budget authority") would clarify some existing budget scorekeeping uncertainties and improve budgetary discipline.

-- The bill would provide for somewhat improved budgeting over federal credit and deposit insurance programs.

-- A requirement that outlays be calculated on a gross basis would provide better disclosure over the magnitude of federal spending.

-- The bill's restrictive definition of government-sponsored enterprises (GSE) is designed to prevent misuse of the GSE concept for moving federal activities off-budget.

GAO Concerns About H.R. 3929

Despite these strengths, the bill has, in our opinion, certain weaknesses which can be summarized as follows:

-- The bill still has a formula feature in the pay-as-you-go approach. This feature would, like GRH, be subject to a new generation of budget accounting gimmicks. This would particularly affect calculations of the baselines that (under H.R. 3929) become the starting point for determining the deficit targets.

-- H.R. 3929 does not set forth an easily understood deficit reduction plan. Whereas the GRH law has a set of stated deficit reduction targets, H.R. 3929 has a formula for computing and recomputing the deficit reduction target each year. This could confuse many people and lessen support for deficit reduction.

-- The pay-as-you-go approach could be manipulated to allow permanent spending increases that are matched by temporary revenue increases. This could give the illusion of deficit reduction progress.

-- The bill's credit budgeting provisions would exclude the nonsubsidy portions of direct loan outlays from the budget's totals. This would lessen the budget's comprehensiveness as a statement of governmental transactions.

We see H.R. 3929 as not going far enough to resolve our concerns about formula budgeting. Like the GRH procedures, the pay-as-you-go procedures would obscure accountability for budgetary results and encourage a new round of budgetary gimmicks. It also does not deal with many of the concerns I have raised in my testimony.

I therefore would suggest that the Subcommittee consider a more comprehensive bill which might include many of H.R. 3929's provisions designed to enhance budget discipline (points of order, definitions, etc.). These provisions in the context of a multiyear bipartisan budget summit agreement could produce better implementation of budget resolution targets than was the case before adoption of the GRH law.

I also urge consideration of GAO's budget restructuring proposal or similar proposals aimed at overcoming the limitations of the current unified budget. Further, the treatment of costs, commitments, and unmet needs should be addressed. I am convinced that sustained progress in overcoming the deficit requires that such matters also be covered in budget reform legislation.

This concludes my remarks, Mr. Chairman. I appreciate having had this opportunity to present our views, and I would be glad to answer any questions you or members of the Subcommittee may have.

 ATTACHMENT I

Masking the Federal Deficits With Trust Funds

Dollars in billions

	Actual			Estimate			
	FY 1985	FY 1986	FY 1989	FY 1990	FY 1991	FY 1993	FY 1995
Revenues	$ 734	$ 769	$ 991	$1,067	$1,137	$1,277	$1,438
Outlays	946	990	1,143	1,226	1,298	1,409	1,548
Total Deficit	$ -212	$ -221	$ -152	$ -159	$ -161	$ -132	$ -110
Federal Funds Deficit	-266	-283	-276	-290	-298	-289	-298
Trust Fund Surpluses:							
Social Security	9	17	52	66	74	98	128
Other Trust Funds	45	45	71	65	64	60	60
Subtotal, Trust Fund Surpluses	54	62	123	131	138	158	188
Total Deficit	$ -212	$ -221	$ -152	$ -159	$ -161	$ -132	$ -110
Total Federal Debt	$1,817	$2,120	$2,866	$3,156	$3,454	$4,012	$4,603

Note: Totals may not add due to rounding.

Source: Actual numbers are from OMB materials. Estimates are from CBO projections.

Fiscal Year 1988 Budget Results Restructured According to GAO Proposal

Dollars in billions

	Total	General	Trust	Enterprise
Operating surplus/deficit (-)	$-131	$-248	$124	$ -7
Capital financing requirements	-24	-23	2	-3
Unified budget financing requirements	$-155	$-271	$126	$-10