



## FIRST PRINCIPLES OF CONGRESSIONAL BUDGETING

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Chairman Price, Ranking Member Van Hollen, and members of the committee: Thank you for inviting me here to discuss the need for a fundamental overhaul of the federal budget process. I applaud you for directing the House Budget Committee's attention to this pivotal issue.

My three-part message today is this.<sup>1</sup> First, Congress should treat the budget process as a means, not an end, and enact reforms accordingly. Second, given the fiscal challenges facing the country, now is not the time for minor tweaking. Instead, now is the time to think big and craft a process that drives legislators to produce credible and sustainable fiscal policy by constraining federal spending both today and tomorrow. Third, any reform should include effective enforcement mechanisms, preferably constitutional in nature, to prevent the new process from suffering the same fate as the current one.<sup>2</sup>

### THE CURRENT BUDGET PROCESS IS A BROKEN TOOL

I begin with a basic question: why should we care about failures in the budget process? Simple: The budget process is a tool, and if it does not work properly, it will hinder Congress's ability to make progress on key fiscal issues. Yet, as Congress undertakes reform and identifies areas in need of change, it will be tempting to focus only on the mechanics of the process—for instance, whether Congress passes a budget resolution or completes all appropriations bills on time. This narrow approach to reform would be a mistake.

1. This testimony is based in part on arguments developed more fully in David M. Primo, "Making Budget Rules Work, 2014 Edition" (Mercatus Research, Mercatus Center at George Mason University, January 2014), <http://mercatus.org/publication/making-budget-rules-work-0>. This testimony also draws in part from previous testimony before the Subcommittee on the Constitution, House Committee on the Judiciary (May 13, 2011), <http://mercatus.org/publication/should-constitution-be-amended-address-federal-deficit>; and the House Committee on the Judiciary (July 24, 2014), <http://mercatus.org/publication/constitutional-solutions-our-escalating-national-debt-examining-balanced-budget>.

2. Standard & Poor's downgraded US federal debt in 2011 in part due to the inability of the federal government to provide a "credible solution to the rising US government debt burden." See Standard & Poor's, "Research Update: United States of America 'AAA/A-1+' Ratings Placed on CreditWatch Negative on Rising Risk of Policy Stalemate" (RatingsDirect report, July 14, 2011), 2.

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Don't misunderstand: the mechanics of the process are important, and the gears are creaky, at best. It is true—this year Congress, led by this committee, passed a joint budget resolution for the first time since 2009. But given progress to date, Congress will almost certainly fail to pass all appropriations bills by the statutory October 1 deadline. Meanwhile, congressional budget rules are routinely gamed, ignored, or changed, which is not surprising given the lack of strong enforcement mechanisms. The process is also incomplete, as the major threat to the federal government's fiscal future—entitlement spending—falls largely outside current procedures.

That said, we should be concerned about process not for process's sake, but rather because of our perilous fiscal situation. In the 40 years since the Congressional Budget and Impoundment Control Act was put into place, the federal government has run a unified budget deficit about 90 percent of the time, with the deficit exceeding 3 percent of GDP (the standard for EU countries) about half of the time.<sup>3</sup> During the same time period, the national debt as a share of GDP has roughly tripled.<sup>4</sup>

Remarkably, the worst is yet to come. The Congressional Budget Office (CBO) estimates in its 2015 long-term budget outlook, using very realistic assumptions about the course of future policy, that the debt held by the public will increase to 175 percent of GDP by 2040.<sup>5</sup>

### THINKING BIG: PROCESS REFORM SHOULD PROMOTE CREDIBLE AND SUSTAINABLE FISCAL POLICY

Given that the status quo is not sustainable, where do we go from here? A reformed budget process that is followed to the letter but fails to control spending in the near term—or that leads to small deficits today while allowing programs like Medicare to ratchet up the federal government's long-term liabilities in relatively hidden ways—is no reform at all. To be effective, therefore, the process must place binding short-run and long-run constraints on spending, and in doing so, force lawmakers to make hard choices.

In the short run, limits should be placed on deficits over a multiyear period while permitting some deficit spending in any given fiscal year to account for economic fluctuations. Switzerland and Germany are two countries that have adopted this “smoothing” approach.<sup>6</sup>

To address long-run fiscal concerns, budgets must account for long-term liabilities from programs like Medicare and Social Security. Congressional reelection motivations make it too tempting for lawmakers to leave difficult decisions about programs like these for tomorrow.<sup>7</sup> Waiting until there is the “political will” to act, however, typically means waiting until a crisis occurs. To prevent such delays, budgets should adhere to targets regarding long-term liabilities at various points over the course of several decades, rather than simply looking 5 or 10 years into the future, as is current practice.

These periodic targets would ensure any hard choices are made in a timely fashion and any significant changes to entitlement programs are implemented gradually to minimize transition costs. In addition, imposing this long-run perspective on budgeting for new policies would help make transparent instances when such programs or regulations create long-term liabilities that are obscured from view today.<sup>8</sup>

3. See Office of Management and Budget, *Historical Tables, Budget of the US Government, Fiscal Year 2016*, “Summary of Receipts, Outlays, and Surpluses or Deficits (-) as Percentages of GDP: 1930–2020,” table 1.2.

4. See Office of Management and Budget, *Historical Tables*, “Federal Debt at the End of Year: 1940–2020,” table 7.1.

5. CBO, *The 2015 Long-Term Budget Outlook* (Congressional Budget Office, June 2015), <http://www.cbo.gov/publication/50250>.

6. Primo, “Making Budget Rules Work, 2014 Edition.”

7. For more details on how the nature of the country's fiscal problems makes reform difficult given the reelection motivations of politicians, see *ibid*.

8. For one approach to considering the total costs of new programs and regulations, see Jason J. Fichtner and Patrick A. McLaughlin, “Legislative Impact Accounting: Rethinking How to Account for Policies' Economic Costs in the Federal Budget Process” (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, June 2015).

To implement rules focused on the long run necessitates the calculation of estimates that are, by their very nature, uncertain. Still, it is better to produce educated estimates than to ignore the problem. No one should reason, “I am not sure how long I will live, so there is no point in planning for retirement.” Yet that is exactly how the federal government prepares its budgets.

### **THE BIGGEST CHALLENGE FOR REFORM SUCCESS: EFFECTIVE ENFORCEMENT MECHANISMS**

Having laid out the direction in which reform should head, I now want to discuss the biggest challenge Congress will face moving forward: making the changes stick. The true measure of success will come when difficult decisions must be made. Will policymakers actually use the process, or will they cast it aside in the interest of political expediency?

History suggests that political expediency will win, and for good reason. Article I, section 5 of the Constitution reads in part, “each House may determine the rules of its proceedings.” This single line gives lawmakers great leeway and has helped create the problem Congress faces today: a budget process that is largely ignored.

The most effective way to ensure durability is a constitutional amendment placing external, enforceable limits on Congress’s ability to tax and spend.<sup>9</sup> A constitutional amendment would counteract the temptation to circumvent rules, and it would also provide a foundation on which the new budget process could be built. In the absence of a constitutional amendment, enforcement options will be much more limited, and success will depend heavily on leadership within the executive and legislative branches.

### **THE PATH FORWARD: MANY QUESTIONS REMAIN**

There is, of course, much more to consider if Congress is serious about reform. Should the congressional committee structure be changed? Should reconciliation be eliminated? How can direct spending programs like Medicare be brought into the budget process in a serious way? Can voters be educated so that electoral incentives encourage fiscal responsibility?<sup>10</sup> How exactly should the country’s liabilities be estimated?

Legislators must also pay careful attention to rule design. Appendix 1 of this testimony lists 10 principles in this regard, including the importance of writing precise rules to prevent legislators from exploiting loopholes and gimmicks to get around the process.

### **CONCLUSION**

In closing, the congressional budget process is in dire need of replacement. Alice Rivlin, former director of both CBO and the Office of Management and Budget, has written, “Process can either hamper decision-making or facilitate it, but only at the margins.”<sup>11</sup> I have a great deal of respect for Dr. Rivlin, and many in the policy community share her views about the limits of process reform. However, “marginal” improvements just won’t do if Congress is serious about tackling the country’s fiscal challenges. As they say, “Go big or go home.”

Thank you again for inviting me to testify today. I welcome your questions.

9. Primo, “Making Budget Rules Work, 2014 Edition.”

10. For a discussion of how to use budget data appropriately, see David M. Primo, “The Uses and Misuses of Budget Data” (Mercatus Research, Mercatus Center at George Mason University, March 2014), <http://mercatus.org/publication/uses-and-misuses-budget-data>.

11. Alice Rivlin, “Rescuing the Budget Process,” *Public Budgeting & Finance* 32, no. 3 (2012), 54.



## TEN PRINCIPLES OF BUDGET RULE DESIGN

BY DAVID M. PRIMO

1. **Use budget rules to change the terms of the debate.** Budget battles will be fought differently if fiscal responsibility is a requirement, not an option.
2. **Apply rules permanently and to the entire federal budget.** Temporary rules or rules exempting certain programs won't help in the long run.
3. **Focus on spending.** Washington cannot address the looming budget crisis without gaining control of the unsustainable spending growth that drives it.
4. **Build flexibility into rules by "smoothing."** Tie budget rule targets or limits to a multiyear period or long-term economic performance to accommodate economic downturns or other transitory events.
5. **Build flexibility into rules by incorporating limited, carefully constructed emergency provisions.** Account for major disruptions like war.
6. **Be precise to prevent loopholes and gimmicks.** History proves that if there is a way around a rule, a legislator will find it.
7. **Pay careful attention to "starting points."** Consider cutting inflated spending levels (e.g., from stimulus) prior to pegging permissible increases to the current budget.
8. **Fight against faux fiscal discipline and resist the temptation to compromise on rule design.** You are better off with no rule than a badly designed one.
9. **Use a commission as a supplement to, not a replacement for, a budget rule.** Commissions are great for specifics, but they can't produce change without some other external pressure.
10. **Incorporate well-designed rules into the US Constitution.** While there are pros and cons to constitutional rules, without this external enforcement, budget rules will always be vulnerable to legislators' propensity to break them.

*These principles are drawn from Primo, "Making Budget Rules Work," 2014.*