COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

The FY 2018 House Budget and Budget Gimmicks

August 4, 2017

The House Budget Committee recently passed a Fiscal Year (FY) 2018 budget resolution that proposes a path to a balanced budget after ten years exclusively through spending cuts. While the budget relies on some gimmicks or very unspecified savings, it also contains some positive steps in limiting gimmicks.

Prior to the budget's release, we warned of eight possible "budget gimmicks" that could be used to make the budget appear more responsible than it is. Though the budget includes substantial legitimate savings, it unfortunately relies on a number of these gimmicks, including:

- Rosy Growth Assumptions
- Unrealistic Policy Assumptions
- Magic Asterisks and Unspecified Savings
- Abuse of OCO

These gimmicks make up $2.9 trillion of the budget's $6.5 trillion in savings compared to current law. Without the largest gimmick of rosy growth assumptions, the debt would still fall, but only to 71 percent of GDP. Without the other unspecified savings and unrealistic assumptions, the debt would *fall* slightly to 76 percent of GDP. However, the budget's 10-year savings are largely symbolic; the gimmicks reduce those savings significantly, but they likely wouldn't occur either way.

At the same time, the budget takes positive steps to crack down on other gimmicks that would affect actual legislation, including:

- Preventing using fee increases to Fannie Mae and Freddie Mac as an offset
- Preventing using Federal Reserve surpluses as an offset
- Phasing down the use of phony CHIMPs as offsets
- Requiring general fund transfer to the Highway Trust Fund be offset
- Using a current law baseline for tax reform.

These improvements would affect actual legislation, making them more meaningful than the negative gimmicks used to reach balance.

These positive steps and more should be included in any future conferenced budget with the Senate.

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Rosy Growth Assumptions ($1.5 trillion)

For the past 25 years, every budget resolution but one based their assumptions for growth on the Congressional Budget Office (CBO). Given an aging population, CBO projects real economic growth will average 1.8 percent over the decade, while other forecasters estimate growth rates between 1.6 and 2.1 percent per year.

In contrast, this resolution assumes 2.6 percent average real GDP growth, well outside of the mainstream and 0.8 percentage points higher than CBO's baseline. It does not include details on tax, immigration, or regulatory reforms to back up its assumptions. That level of growth will require many positive policy changes and significant luck.

These rosy assumptions make the budget's forecast look $1.5 trillion better by assuming higher revenue collection and GDP, thus decreasing debt and deficits as a share of the economy.

Previous budget resolutions have incorporated much more modest feedback effects from growth based on the budget's deficit reduction, calculated by the Congressional Budget Office (CBO). In the past few years, growth has accounted for less than 5 percent of savings as opposed to about 25 percent in this one.

This gimmick is common in small doses among Presidents' budgets (and this year's used an extreme version). To be credible, the Congressional budgets should rely on CBO's growth assumptions, possibly allowing for modest macroeconomic feedback for deficit reduction or other tangible proposals if the estimates are provided by CBO for the purpose of the budget.

Unrealistic Policy Assumptions ($750 billion)

Unrealistic policy assumptions have estimated savings that are unrealistically high. Specifically, the House budget assumes $700 billion in savings by cutting the annual amount of improper payments in half within five years. This is a huge and arbitrary amount without any guidance how to achieve these savings except by creating a commission.

The budget also overestimates savings from reducing improper payments since they are not all overpayments: some are underpayments, while some may be correct but the federal government cannot verify their accuracy. Thus, even if policymakers did cut improper payments in half, the amount of savings would be lower than assumed in the budget.

The President's budget relied on a smaller version of this gimmick, with a smaller amount and more detail. It assumed that the Administration would cut all improper payments in half with increased program integrity funding but would only save $139 billion. That was also an arbitrary assumption that is unlikely to be achieved. President Obama's last budget contained only $11 billion in program integrity savings, and it could be challenging to achieve even that much, given the deep cuts proposed in this year's budgets that could hamper existing efforts to reduce improper payments.

Reducing improper payments is a matter of good governance and should be pursued, but the amount of savings in the House budget is 50 to 100 times too much. We previously estimated that about $14 billion in improper payments savings were possible in the President's budget. The extra amount saved from this gimmick is $750 billion including interest over ten years.

Magic Asterisks and Unspecified Savings ($620 billion)

We also warned about "magic asterisks," where a budget takes credit for savings without specifying the policies that produce them. Savings levels in each budget function (like defense, transportation, and education) should be backed up with specific examples that could legitimately cover the costs. Undistributed cuts should be used only sparingly to reflect policies that may cut across multiple functions or legitimate rescissions, not as a mechanism to make the numbers add up.

Unfortunately, the House budget contains $570 billion in undistributed outlay savings above the reduction in improper payments discussed above. Of these, $450 billion are discretionary savings, which is over 40 percent of the net discretionary cuts compared to the January CBO baseline.

Unspecified savings account for about $620 billion of the budget's savings (including interest) over ten years.

Abuse of OCO (at least $10 billion)

Overseas Contingency Operations (OCO) is a type of spending not subject to the budgetary restraints put in place by the Budget Control Act (BCA) of 2011. It is intended to apply to "war spending" related to Iraq and Afghanistan.

There are no criteria for what can be designated as OCO funding, and this designation circumvents the budget caps both parties agreed to under the BCA. The lack of restrictions create the opportunity to effectively backfill defense spending above the caps by pushing non-war spending into OCO. Lawmakers have done this routinely in recent years.

The budget increases war spending by $10 billion above President Trump's request for FY 2018, effectively using OCO as a gimmick to backfill normal defense spending needs. Lawmakers should not appropriate more than the $77 billion in the President's request.

Positive Steps on Gimmicks

Though the House budget uses several gimmicks, it also contains several praiseworthy provisions to limit specific budget gimmicks in future legislation. If the proposed budget were to be adopted, these limits would prevent this year's legislation from using these gimmicks. These should be contained in a future enforceable concurrent budget resolution.

The budget resolution limits the use of four gimmicks. First, it prevents fee increases to Fannie Mae and Freddie Mac from being used as an offset. The mortgage guarantees from these government-sponsored enterprises are expected to cost the federal government approximately $16 billion over a decade. Since the increased fees would help cover Fannie and Freddie's liabilities, this budget resolution prevents the revenue from being double-counted to pay for something else.

Second, it prohibits using Federal Reserve surpluses as an offset, which achieves no actual savings because it just transfers money from the Federal Reserve that would be eventually remitted to the government as profit anyway. We criticized this gimmick when it was used in the 2015 highway bill.

Third, the budget continues to phase down the use of phony changes in mandatory programs (CHIMPs) with no outlay savings as offsets for appropriations. Limits were first established in the FY 2016 budget.

Finally, it requires that any general fund transfer to the Highway Trust Fund be offset. Under standard scoring rules, the transfer is not counted as a cost, even though it increases allowable spending.

There are also variety of gimmicks the budget does not use, which is also praiseworthy.

The most prominent gimmick not used: a current policy baseline to measure tax reform, which would allow tax reform to cut taxes by approximately $460 billion while claiming to be revenue neutral. The House "Better Way" tax plan calls for the use of this gimmick, and rejecting it is one of the budget's most important steps towards fiscal responsibility. Reconciliation legislation, including tax reform, would instead be enforced using a current law revenue baseline.

The budget did not specify whether tax reform will be measured using dynamic or conventional scoring. Ideally, tax reform should be measured using conventional scoring so as not to rely on an uncertain forecast of economic growth. Any dynamic gains should be devoted to deficit reduction.

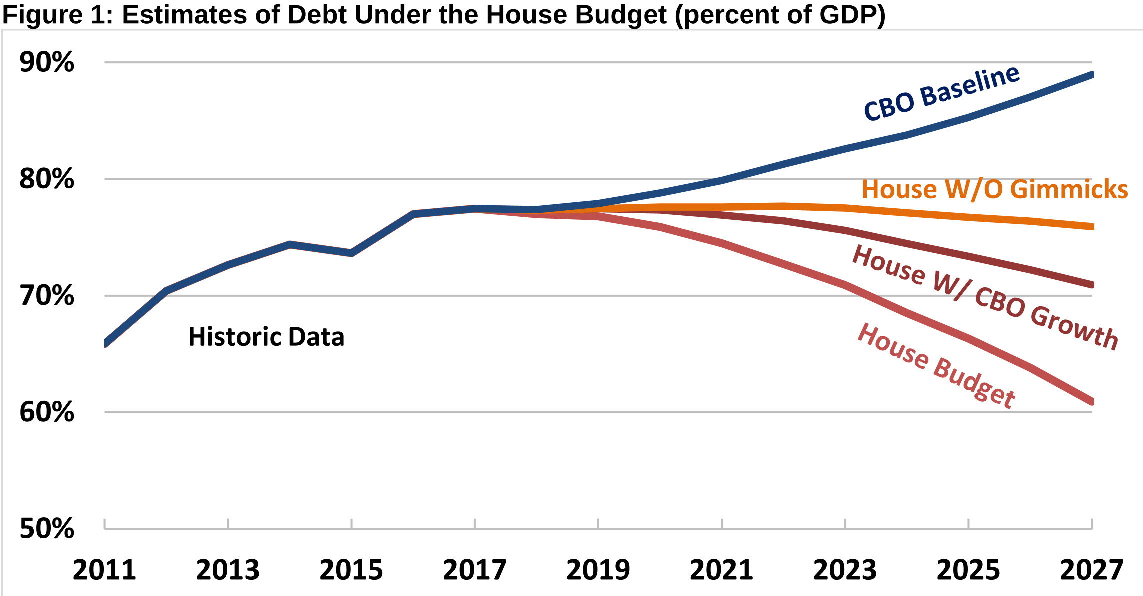
In addition, while this budget does assume $1.5 trillion in savings from the economic effect of largely unspecified policies, at least the budget does not double count this growth effect to pay for other proposals as the President's budget did.

Finally, this budget only uses the OCO gimmick to backfill defense spending, not non-defense discretionary spending as lawmakers have done in the past few years.

Adding It All Up – How Much Does the Budget Really Reduce Deficits and Debt?

In total, these gimmicks reduce the House budget's projected deficit reduction by $2.9 trillion, from $6.5 trillion to $3.6 trillion. This means debt would fall to 76 percent of Gross Domestic Product (GDP) by 2027 rather than 61 percent as the budget projects. This would still be an improvement over CBO's January projection that debt will rise to 89 percent of GDP by 2027.

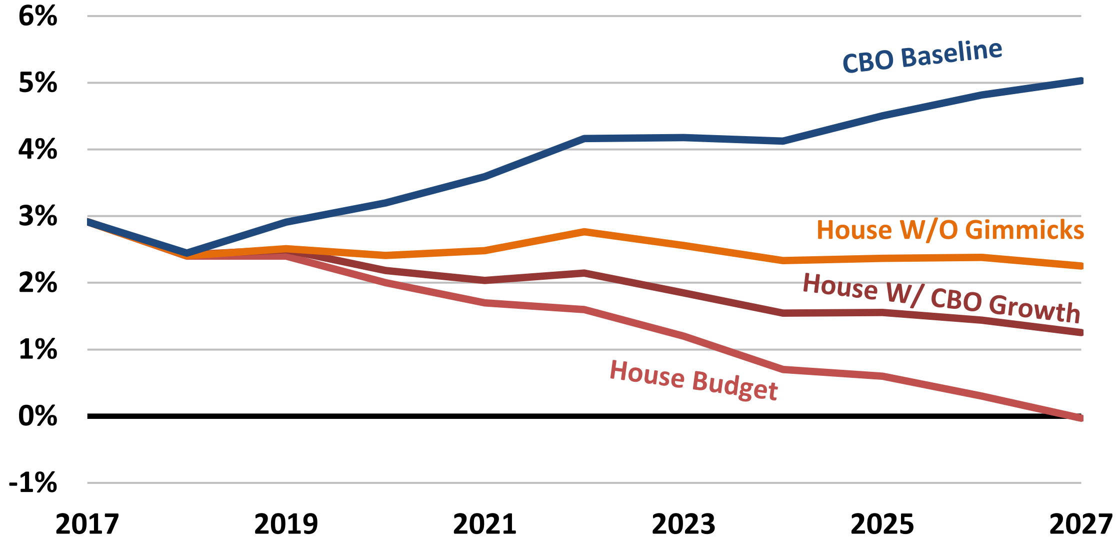
Figure 1: Estimates of Debt Under the House Budget (percent of GDP)



Sources: CBO, House Budget Committee, CRFB calculations.

It also means the budget would not balance in 2027, instead showing a $630 billion deficit (2.3 percent of GDP). Still, this is a large improvement over CBO's projection of a $1.4 trillion deficit in 2027 (5.0 percent of GDP).

Figure 2: Deficit Under the Chairman Black's Budget (percent of GDP)



Sources: CBO, House Budget Committee, CRFB calculations.

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The United States faces serious fiscal challenges, with high and rising debt for the foreseeable future. Gimmicks make it difficult to take Congress' commitment to fiscal responsibility seriously. Even though the budget relies on some gimmicks to help the budget balance on paper, it contains meaningful improvements that would prevent gimmicks from being used in future legislation.