Fiscal and Economic Goals and the Budget Resolution - Introduction

The following document is a staff working paper and is part of a series of reports and memoranda prepared by Commission staff on budget concepts, budget process, and other issues. These papers are drafts that are subject to revision, and do not represent the official position of the Commission or its funders and any views and opinions expressed are those of the authors.

The budget resolution should prompt debate about the implications of budgetary choices and aggregate totals for fiscal and economic policy, both near- and longer-term. While budgetary levels and enforcement are critical, the budget process should be designed to increase the fiscal and macroeconomic implications of budgeting. This memo discusses options for increasing this focus through the development of better metrics, assessments of the macroeconomic implications of various budget plans, and the possible adoption of fiscal goals and targets.

Key Questions

As we consider potential changes in the congressional budget process, it is important to assess whether the current process has succeeded in refocusing the congressional budget debate on overall fiscal policy. Congress does include fiscal policy targets in the budget resolution and the debate does to some extent revolve around comparing the fiscal policy goals endorsed by the Congress with those of the president.

The Commission needs to consider whether we should enhance the focus of the congressional budget resolution and process on fiscal policy, and if so, what kinds of policy indicators and targets should be highlighted. The discussion will concentrate on four key questions:

- ***Metrics and indicators*** – what kinds of indicators and metrics should be included in the budget resolution and committee reports that tie budget decisions to overall fiscal policy?
- ***Tracking and assessment*** – to what extent should the implications of congressional budget decisions for the budget and economy be tracked and how might this be accomplished?
- ***Goals and targets*** – should Congress adopt targets or goals for fiscal policy that would provide a set of constraints for subsequent decisions? How should these targets or goals be tracked and enforced, if at all?
- ***Long-term dimension*** – how can the long-term impacts of current fiscal policies be tracked and reflected in congressional budget resolutions and reports?

Metrics

The choice of metrics should ultimately be informed by the kind of debate that Congress wishes to have on its own decision making. There are a range of fiscal and economic indicators that are candidates for incorporation into the congressional budget process.

Ideally, the indicators chosen should reflect budgetary commitments in total as well as important economic consequences. Beyond this, however, indicators should have features that enable them to be useful and easily used by decision makers such as:

- ***Simplicity*** – is it readily understandable?
- ***Transparency*** – are the assumptions clear and disclosed?
- ***Credibility*** – is it considered legitimate by analytic communities?
- ***Feasibility*** – are information and data readily available?

On the fiscal side, the congressional budget resolution includes traditional fiscal indicators including the total deficit, the on- and off-budget deficits, and total debt and publicly held debt over a five- or 10-year basis.

Other kinds of indictors and metrics could be considered. For instance, the president's budget has added a new category – debt net of financial assets – to reflect the exponential growth in government ownership of private financial assets. Some economists have argued that the overall fiscal bottom line should be adjusted to reflect the impact of the economy on the budget and the nature of differing kinds of spending. While too many to enumerate here, some of the major categories include:

- ***The structural balance*** – adjusting for the cyclical effects of the economic cycle on both revenues and spending can help separate the influence of short-term economic forces from longer-term imbalances in government spending and revenues
- ***The standardized balance*** – adjusts for other transitory items such as receipts from allies for Desert Storm or deposit insurance outlays for failed savings and loans
- ***The primary balance*** – excludes interest on servicing the previous debt, thereby enhancing the effects of budget policies on future obligations
- ***The capital budget*** – separates spending deemed to have longer-term investment character from operating budget expenditures

The president's budget also tracks the implications of his budget for key economic indicators, such as unemployment, GDP growth, and inflation. The Congressional Budget Office (CBO) assesses his budget against its own measures of these indicators. The congressional budget resolution typically does not adopt or track its own economic measures to assess the impacts of its fiscal policy decisions.

Assessments

The implications of the president's budget for fiscal policy and economic outcomes are a primary focus of his own budget and of the national debate. This is not only an expectation for the budget document itself, but also for the president, who is held accountable by the public for the performance of the economy on his watch. This may contribute to the greater attention paid to his own fiscal policy targets than to those of the Congress. While Congress's overall standing in the polls may suffer along with the economy, members generally don't face the consequences for economic outcomes in the same way as the president does.

This is reflected in the tracking and assessment of budget goals and targets. For instance, CBO does an assessment of the president's budget each year, comparing it to the baseline and repricing the budget based on CBO's economic and budget assumptions and concepts.[1] By contrast, Congress does not generally assess the economic consequences of its own overall macro policy choices. Nor does CBO assess and compare the congressional budget resolution to the baseline.

CBO could assess the fiscal policy of the budget resolution against its baseline and make some evaluation of how the congressional fiscal policy might affect key economic indicators. Such an assessment might help promote a more healthy debate and upgrade the perceived stakes of the congressional budget resolution. Congress would have to consider whether it is comfortable with the greater scrutiny that might invariably accompany such an assessment. It may serve the purpose of increasing the visibility and perceived importance of the budget resolution itself.

Goals and targets

Congress could go further by establishing explicit goals and targets in the budget resolution that could be tracked through subsequent congressional policy processes, both in the budget year in the out-years. For most of our history, we had a familiar refrain that served as our implicit fiscal policy goal – a balanced budget. And until the late 1960s, we largely managed to achieve balance in surplus except during wars and depressions. Having fallen from grace, budget balance was replaced by a succession of goals that were part realistic and part opportunistic – full employment balance, saving Social Security, and cutting deficits in half have supplanted budget balance as more reachable and politically feasible goals for presidents.

European Union experience The question is whether Congress would find it useful to adopt overarching fiscal goals or targets. Many other nations have articulated such goals, which have framed budget decisions by reference to broad goals expressed in separate statutes or other platforms. The Growth and Stability Pact (GSP) of the European Union

[1] Congressional Budget Office, *A Preliminary Analysis of the President's Budget and an Update of CBO's Budget and Economic Outlook*, March 2009.

is a prominent example, with deficit targets of three percent of GDP – targets that have often been breached even in good economic times.[2]

Other nations Individual nations have reached for goals which have had better resonance and political sustainability than that of the GSP. Sweden followed the goal of achieving surpluses over the business cycle, while New Zealand observed a budget consistent with maintaining debt at 20 percent of GDP. These goals gained sufficient bipartisan support to enable each of these nations to sustain surpluses for a number of years in this decade. These experiences attest that a fiscal goal can make continued restraint acceptable, if anchored by a compelling rationale endorsed by key political leaders. In both cases, earlier fiscal and economic crises made fiscal goals symbolically important, and leaders risked shame if their fiscal outcomes fell short. These experiences also suggest that, at times, goals and targets can have leverage over behavior apart from detailed enforcement regimes.

GRH deficit targets Congress last set overarching fiscal goals under the 1985 Gramm-Rudman-Hollings Act, which prescribed declining deficit targets for the federal budget. However, these were applied in a mechanical fashion that proved to be politically unsustainable, as economic changes moved the goal line further away regardless of the actions taken by decision makers. Unable or unwilling to meet these targets, Congress passed the Budget Enforcement Act (BEA), which instituted caps on discretionary appropriations, a pay-as-you-go (PAYGO) rule, entitlement increases and tax cuts. The focus of these controls was on holding decision makers accountable for what they directly controlled – laws providing appropriations, increasing entitlement spending, or reducing revenue. While less ambitious and easier to enforce, the BEA regime did not address the growth of spending or revenue losses for existing programs.

Deficit fiscal targets Has the abandonment of overarching fiscal policy goals and targets left Congress without a compelling framework to justify current and future fiscal sacrifice in the face of competing, and often equally compelling, claims? Fiscal goals, rules, and limits all represent attempts by leaders to wrest control over the definition of the issues at stake from others with competing frames and definitions. Congress also has left a void in economic and fiscal leadership that has been filled by the president, who has often not been shy about asserting his own set of fiscal goals.

Some observers have suggested that "hard" targets may still be feasible if the savings required to achieve the targets are relatively modest, adjustments are made for the economic cycle, and reductions are targeted toward programs most responsible for the breach and achieve savings through policies that address the underlying cause of the breach.

Others argue for "soft" targets that do not trigger any formulaic reduction in spending or increase in revenue if the targets are exceeded. These soft targets are predicated on

[2] James D. Savage and Amy Verdun, "Reforming Europe's Stability and Growth Pact: Lessons From the American Experience in Macrobudgeting," *Review of International Political Economy*, 14:5 (December 2007), 842–867; Joseph Minarik and Barry Anderson, "Design Choices for Fiscal Policy Rules", *OECD Journal of Budgeting,* (159-208), Volume 5 - No. 4 (2006).

focusing public attention on the breach and forcing Congress to at least acknowledge a breach of a target through a vote on a measure to address the breach or raise the target.

A key question is whether the risks that political leaders take with deficit targets could be mitigated through adjusting the targets for structural fiscal factors to account for the influence of the economic cycle.

Spending limits Some argue that Congress should avoid deficits and debt and focus instead on spending targets, which are more controllable. There are clear trade-offs here, for sure – spending targets are more controllable but also less compelling to the public. As the deficit and debt levels grow to worrisome proportions, a budget framework that does not address these issues will risk losing credibility with the public and, possibly, with international credit markets. Other nations adopting deficit- or debt-based fiscal policy targets faced the risks of being held accountable for actions they did not completely control, but they had little choice as they were trying to regain the support of international markets and publics eager for signs of fiscal resolve.

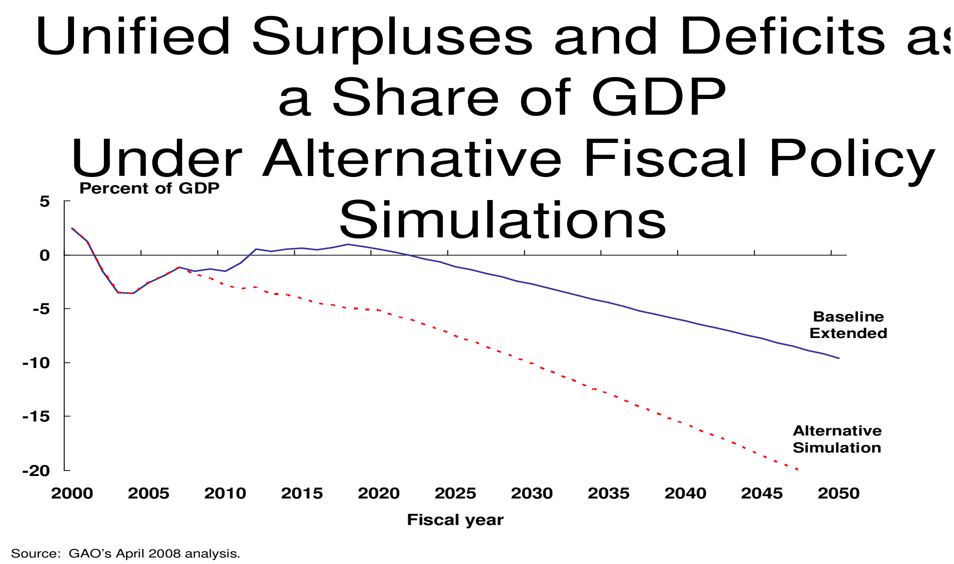
Tracking long-term fiscal sustainability

The United States, like other advanced economies, faces unprecedented budget challenges, thanks to rising health-care costs and the aging of our population. A consensus exists that over the longer term the federal budget is on an unsustainable course. Further, there is broad agreement that early action is preferable to waiting for a crisis that ties our collective hands and forces precipitous policy actions. Setting fiscal goals and targets with an eye toward the long-term outlook may help raise the salience of these issues and ultimately bring about greater resolve to deal with these problems sooner rather than later.

Types of metrics What kinds of metrics or goals could help promote greater attention to the long-term fiscal challenges? No one would suggest that we should budget for the next 50 or 75 years. The real issue is whether we can establish a framework for examining the longer-term implications of our short-term budget decisions. And whether we can establish a regime that forces us to periodically reexamine the affordability of current spending commitments and revenue policies.

Consistent with the framework above, we will first consider metrics for tracking the long-term implications of our current decisions. Several alternatives exist at the macro level:

- Long-term sustainability analysis of current and alternative fiscal policy paths. Such an analysis reveals the deficits and debt over the longer term on a year-to-year basis from following the baseline or alternative fiscal policy options. The following chart from Government Accountability Office (GAO) is an example of such an analysis of the baseline, adjusted for the extension of the Bush tax cuts and other expiring tax provisions.



- Fiscal gap – this is a net present value number that measures the size of the immediate and permanent increase in taxes or non-interest spending reductions needed to maintain the same debt-to-GDP ratio over the longer term as we have today. GAO's model showed in 2008 that the fiscal gap in September was 6.7 percent of the economy, requiring a 35 percent increase in revenues or a comparable decrease in spending to fill the gap.

- Fiscal exposures – While not a macro picture of the entire long-term outlook of fiscal policy, this measure reflects the net present value of the major spending commitments of government over a long-term horizon. GAO developed this concept to encompass long-term financial commitments recorded on the government's financial statements, such as debt held by the public, as well as those programs with long-term spending expectations that are not currently considered liabilities, including Social Security and Medicare.[3] The Peterson Foundation has added these exposures to arrive at a total figure of $56 trillion on a net present value basis that some argue constitutes a future claim on budgetary resources.

Fiscal sustainability metrics could be used in several ways in the congressional budget process:

- More fully integrate current fiscal sustainability projections by the Office of Management and Budget (OMB) and CBO into the baseline assessments of both agencies. OMB's long-term model is presented in its *Analytical Perspectives*

[3] U.S. Government Accountability Office, *Fiscal Exposures: Improving the Budgetary Focus on Long-Term Costs and Uncertainties*, GAO-03-213, January 23, 2003.

publication, while CBO's model is presented in a separate report that is published biennially at a different time than its baseline January report.

- Have CBO assess the long-term fiscal implications of both the president's budget and the congressional budget resolution on a routine basis as a matter of public reporting.
- Establish a point of order that could be raised against moving a budget resolution that CBO estimates would worsen the long-term budget outlook. This could be waived by the usual processes in the House and Senate but it would heighten awareness of the long-term dimensions of budget decisions during the budget resolution formulation process
- Establish targets for spending or overall deficits and debt in the near term that corresponds to long-term sustainability goals. The preceding point of order option would give congressional budget committees an incentive to think about shorter-term fiscal policies with an eye to their longer-term implications for sustainability.

The fiscal exposure metric can also be used as a basis for debate through several measures:

- Require annual reports on fiscal exposures by both OMB and CBO. This could be supplemented by including a net present value number to capture the long-term costs of specific program activities in the budget.
- Work with CBO to prepare estimates for new proposals resulting in changes to existing exposures or new exposures that measure the longer-term net present value costs of these commitments.
- Establish a new point of order lying against expansion of exposures with the usual procedures in House and Senate for consideration.
- Develop a trigger mechanism to periodically force an assessment and reexamination of existing exposures when they cross a "trip wire" designated by Congress. (This will be examined in more depth in subsequent meetings.)

All of these measures would increase the salience of the long-term outlook by providing enhanced information and establishing new incentives for members to consider the long term in addressing current budget choices. The technical and conceptual challenges associated with producing and measuring long-term fiscal indicators should not be underestimated. Assumptions on productivity, interest rates, health-care costs and other key variables are critical. OMB, CBO, and GAO have been working on these issues for many years and have developed models and routines for testing assumptions. One approach for easing in the implementation of these measures would be to phase in the information requirements – first giving analytic agencies time to establish credible metrics that could then be used as a basis for points of order and other real-time budget decisions.