COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

Beware of Budget Gimmicks
December 4, 2013

We are hopeful that the budget conference committee will be successful in replacing a portion of the sequester with better-targeted reforms that will improve the long-term fiscal health of the country. Even a modestly sized deal can help show that Congress can take steps to improve the budget picture.

To be credible, a deal must not rely on budget gimmicks to create or inflate the appearance of savings. Gimmicks would exacerbate an already unsustainable fiscal picture and would undermine the country's fiscal credibility by sending a message to the public and markets that lawmakers are unable to confront the hard choices necessary to put the debt on a sustainable trajectory.

CRFB's previous analysis, "What We Hope to See from the Budget Conference Committee," outlined different gimmicks that the conferees could use. This paper discusses many of those budgetary sleights of hand in detail, including:

- Counting phony drawdown savings related to the wars in Iraq and Afghanistan and one-time Superstorm Sandy aid
- Relying on timing shifts or one-time savings instead of true deficit reduction
- Ignoring the costs of policies currently in place and likely to be extended, such as the "doc fixes" for the Medicare Sustainable Growth Rate
- Double-counting savings for deficit reduction and other purposes
- Excessively back loading savings in future years, with the intention that lawmakers will reverse them in the future
- Offsetting short-term sequester relief by increasing future sequester cuts
- Transferring money, without offsets, from general revenue into trust funds

Phony Drawdown Savings

While most discretionary spending is subject to spending caps set in the Budget Control Act, discretionary spending on the wars overseas and for emergency disaster relief related to Superstorm Sandy is not subject to annual caps. Without caps, budgetary conventions force CBO to assume that such discretionary spending grows with inflation, even when that is not the intended policy and most likely will not actually occur.

As a result, lawmakers can claim "savings" for drawing down war spending by setting spending caps consistent with the war drawdown already occurring.

Enacting these budgetary caps makes all the sense in the world, but counting the difference between those caps and CBO's extrapolation does not represent new deficit reduction given the plans for troop withdrawal have long been in effect. Counting the absence of additional Sandy-level emergency aid as savings would represent a similar gimmick.

Claiming the more than $800 billion difference between the CBO baseline and actual intended war and Sandy aid levels as deficit reduction would be quite misleading. It would be far more dangerous, however, to use these phony savings to offset new spending or sequester relief. Not only would this reflect dishonest budgeting but would actually make our debt problem worse.

For more information on this gimmick, click here.

Timing Shifts and One-Time Savings

The standard budget window that CBO uses to evaluate major legislative changes is ten years, and effects beyond this window are rarely measured. In the past, lawmakers have taken advantage of this timeframe to enact policies that reduce deficits over the first decade but do not reduce them as significantly (and in some cases even increase them) in subsequent years.

These timing shifts can take a number of forms. Among the more egregious approaches are back loading or phasing in costs so they appear less expensive, explicitly changing the timing of certain collections or outlays, or relying on policies that shift savings into the window and create costs outside the window.

The latter approach has been used twice in recent years. A "Roth conversion" provision in the fiscal cliff legislation allowed certain workers to pay taxes on their retirement account income now instead of paying it later – increasing short-term revenue gains by ensuring long-term revenue losses. Similarly, a "pension smoothing" provision in last year's highway bill allowed corporations to change the timing of pension contributions, effectively increasing taxable corporate earnings (and therefore revenue) for six years before eventually reversing those gains.

In addition to explicit timing gimmicks, some sensible policy reforms (for example, reforming accelerated depreciation rules) have the unintended side effect of saving less in future decades than in the first. In these cases, lawmakers should take into account the long-term impact of changes to ensure that they are on the whole improving rather than worsening the long-term fiscal picture.

The same principle should apply to one-time savings from policies like selling assets, accelerating implementation of policies already in place, or imposing transition taxes or charges. The policies might represent sensible improvements and could help to modestly reduce debt levels. However, it would be a budget gimmick to pretend these savings lead to permanent deficit reduction or to use these one-time savings to pay for policies that increase the deficit over the long term. Using temporary savings to finance temporary sequester relief would not constitute a gimmick, but would be a mistake as one of the key goals of the conferees should be to replace mindless temporary sequester cuts with permanent long-term reforms.

For more information on how to avoid timing shifts, click here.

Ignoring Policies Currently in Place and Likely to Be Extended

Several policies scheduled to expire in the coming months or years have been routinely extended. For example, physicians currently face a nearly 25 percent cut in their Medicare payments under the Sustainable Growth Rate formula, but Congress has routinely "patched" their payments to avoid this cut. Claiming either "savings" or lower debt levels by assuming expirations that will never be allowed to occur would be a gimmick.

A related gimmick would be to create new SGR-like policies and assume they will be temporary even though they would likely be extended. The American Recovery and Reinvestment Act (ARRA), for example, included expansions to the Child Tax Credit, Earned Income Tax Credit, Hope Tax Credit, and Pell Grants. All were claimed as temporary, but intended to continue on a permanent basis – and all have been extended numerous times since ARRA.

Double-Counting Savings

Double-counting budget savings is a massive budget gimmick. One easy way to double count savings would be to take advantage of scoring rules related to changes in federal employee retirement contributions. Both Republicans and Democrats have sensibly proposed increasing retirement contributions by federal civilian workers to improve the fiscal situation. However, for technical reasons such a proposal could produce scoreable savings for sequester relief *and* allow the same amount of savings to create more room under the discretionary caps, allowing agencies to spend the same amount elsewhere. Allowing this to occur would double-count the savings and ultimately add to the deficit.

Similarly, policymakers could easily double count various reforms to civilian and military retirement benefits and to certain military health benefits. They should avoid doing so.

For more information on this gimmick, click here.

Excessively Back-Loading Savings

One way lawmakers can create the appearance of savings – and sometimes even significant savings – is to delay large and abrupt savings until later in the decade. There is nothing wrong with back-loading savings, per se. In fact, doing so can leave room for the economy to recover, give people more time to prepare, and significantly improve the long-term fiscal situation.

However, *excessive* back-loading could be used to mask lawmakers' intent to repeal those savings at a later date and could result in policy decisions that prove difficult to implement.

For example, a reduction in discretionary caps that did not begin until 2020 would not be viewed as credible, and the credibility of a massive tax rate increase in the same year would also likely be viewed with skepticism.

Identifying the precise line between sensible and excessive back-loading is difficult. In general, sensible and credible policy should gradually phase in changes beginning in the next few years, rather than starting them abruptly in the distant future.

Shifting the Sequester Cuts

Lawmakers may be tempted to reduce the size of the sequester cuts in the near-term by shifting the cuts later in the decade. While some amount of "smoothing" might make sense in the context of a permanent sequester relief plan, simply trading cuts today for even deeper cuts tomorrow would have little credibility. After all, if the sequester is too big to handle today, how could policymakers accept a bigger version of sequester in future years?

In addition to raising credibility concerns, this sequester shifting could lead to a continuous cycle in which Congress continues to avoid current cuts by pushing them to the future in perpetuity. Congress relied on a similar gimmick with the Medicare Sustainable Growth Rate, which requires cuts in Medicare payments to physicians. Congress repeatedly delayed those cuts by requiring greater savings in the following year, which compounded over time. The result is an SGR formula that requires unrealistically deep cuts (24 percent in January), which nobody expects to be implemented.

Such a cycle would permanently add to the debt, and put Congress in the position of continuously governing by crisis to offset an ever-growing sequester cut year after year. Short-term sequester relief should be paid for with permanent mandatory cuts or new receipts – not by deepening sequester cuts in future years.

For more information about this gimmick, click here.

Trust Fund Revenue Transfers

Several government trust funds face funding shortfalls, where the dedicated revenue is not enough to cover expenses. Over the next decade, the transportation trust funds face a roughly $130 billion funding gap, and the Social Security Disability Insurance (DI) trust fund faces a $240 billion gap. With regards to the transportation trust funds, lawmakers have recently relied on transferring general revenue into the trust fund to plug shortfalls, rather than reducing highway spending or increasing the dedicated revenues that fund it.

Under current budget scoring rules, general revenue transfers are treated as intergovernmental transfers with no cost, even though they allow for greater spending than would be the case if the trust fund were exhausted. The House-passed budget resolution included a provision requiring that a general revenue transfer to the highway trust fund be scored with a cost for purposes of budget enforcement, as should be the case.[i] Similarly, if policymakers transfer any money into the DI trust fund, those transfers should be counted as a cost in need of offsets.

If lawmakers want to responsibly address trust fund shortfalls, they should make changes to spending levels and dedicated revenues within those trust funds, ideally finding long-term solutions to close structural shortfalls. If general revenue funds do prove necessary, lawmakers should fully offset any costs.

Conclusion

Lawmakers must avoid relying on budget gimmicks to offset sequester relief, claim savings for deficit reduction, or hide the true costs of their decisions. Considering the long-term trajectory of federal debt, lawmakers will need to undertake serious and difficult steps to improve our fiscal situation. Using budget gimmicks will show that they are not serious about the debt issue and may actually be making it worse.

As CBO Director Douglas Elmendorf said during his remarks to the budget conference committee, lawmakers should ideally seek to identify large solutions that adequately address our long-term challenges. However, he cautioned that "no steps at all would be better than stepping backward."[ii] Relying on budget gimmicks would undoubtedly be a step backward.

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[i] Relying on general revenue transfers to the highway trust fund would not violate statutory PAYGO because it only applies to mandatory spending outlays and revenues. A general revenue transfer to the highway trust fund would increase mandatory contract authority and allow for increased discretionary outlays by preventing trust fund exhaustion, PAYGO applies to increases in the deficit, which is measured in outlays, so an increase in mandatory contract authority is not subject to PAYGO. At the same time, the discretionary spending caps limit the amount of discretionary budget authority Congress can provide, the increase in discretionary outlays made possible by the general revenue transfer would not be subject to discretionary spending caps.

[ii] Douglas Elmendorf. Testimony before the Budget Conference Committee, November 13, 2013.