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Testimony of The Honorable Leon E. Panetta Hearing before the Joint Select Committee on Budget and Appropriations Process Reform:

Opportunities to Improve the Appropriations Process July 12, 2018

Co-Chair Womack, Co-Chair Lowey, and Members of the Joint Select Committee:
Thank you for inviting me to discuss the budget and appropriations process and potential budget process reforms. I appear before you as Co-Chair, I serve along with Mitch Daniels and Tim Penny, of the Committee for a Responsible Federal Budget. I am aware that Maya MacGuineas, our President, testified before you on May 24, 2018 and I do endorse many of the recommendations she made in her testimony.

But in addition, I appear before you as both a past member and Chairman of the House Budget Committee, a participant in all of the major budget summits during the 1980's and 1990's, and as a former Director of the Office of Management and Budget during the first two years of the Clinton Administration. As Director of the CIA and Secretary of Defense in the first four years of the Obama Administration, I experienced some of the failings of the budget process particularly with regard to the defense budget and sequestration.

Based on all of those experiences, I would like to address the following in this testimony:

1. The history of the budget process and how it worked during the time I served as a member and Chairman of the Budget Committee and OMB Director;
2. Why the current budget process is broken;
3. Recommendations for budget process reforms;
4. The bipartisan political leadership and the need for a comprehensive budget agreement;
5. How Congress should proceed without a comprehensive budget agreement; and
6. Summary.



History of the Budget Process

1. Early years of the budget process and importance of bipartisanship

The Congressional Budget and Impoundment Control Act was passed by an overwhelming bipartisan vote in both the House and Senate in 1974: the conference report passed the Senate 75-0, the House 401-6. For over 20 years, the budget resolution process worked largely because the early chairmen and ranking members worked closely together—Brock Adams, Bob Giaimo, Del Latta, Ed Muskie, Pete Domenici, Jim Jones.

Bill Gradison and Bill Frenzel served as my ranking members when I was Chairman. Congress always passed a joint budget resolution, reaching agreement between the chambers, even in the 6 years in the 1980's when different parties controlled each chamber. The first year where a joint budget resolution was not agreed to was for Fiscal Year 1999. None of this was easy and there were intense battles over the level of funding for education, defense and other areas. But ultimately compromise was arrived at because neither party believed it was in their interest or the interest of the country to have the budget process fail.

2. Confronting growing deficits in the 1980's and 1990's

Deficits grew for much of the 1980's, dipped in the late 1980's and were rising again in the early 1990's. In 1982, the deficit was 2.5% of GDP. By 1983, the deficit had more than doubled to 5.9% of GDP due largely to the large Reagan tax cuts—\$749 billion over five years—enacted in 1981. Because of the concern over deficits, in the spring of 1982, Senate Finance Committee Chairman Bob Dole with the support of the Reagan Administration developed legislation that increased taxes by \$98.3 billion over three years.

The measure closed tax loopholes and increased taxpayer compliance. Deficits stayed in the 5% range through 1984-1986 before dipping as a result of the increase in taxes and bipartisan budget agreements in 1987 after the stock market crash. By 1992, however, the deficit had climbed back to 4.5%. As a result the debt, at a level of 25% of GDP in 1981, climbed to 35% of GDP by 1985 and peaked at almost 48% in 1993-1994. Ross Perot's campaign for the presidency in 1992 made the growing deficit a major focus of his campaign and the growing deficits forced action by both Presidents Bush and Clinton.

3. The Reagan Budget, Reconciliation and Gramm-Rudman-Hollings

When the first Reagan budget was passed in 1981 it contained for the first time in the history of the Budget Act mandatory reconciliation instructions to achieve investment savings. Committees were required to meet savings targets and those savings were incorporated into an omnibus reconciliation bill. Even though the Reagan budget passed when the rule on the budget resolution approved by the Committee was defeated, the reconciliation process was handled by bipartisan process. The same was true in the passage of the Gramm-Rudman-Hollings Act, which established annual spending reduction targets enforced by sequestration. Those targets, however, were modified in bipartisan votes and eventually superseded by the 1990 Budget Agreement.



4. The 1990 Budget Summit and Agreement

Because of increasing budget deficits and the need to increase the debt limit by close to \$1 trillion (\$915 billion), the Bush Administration and the Congressional leadership agreed to a set of discussions that culminated in a month long negotiation session at Andrews Air Force Base. The bipartisan agreement was that if the Democrats could agree on approximately \$250 billion in entitlement and discretionary savings, the Republicans would be willing to consider approximately \$250 billion in tax increases. The Omnibus Budget Reconciliation Act (OBRA) of 1990 raised the debt limit by \$915 billion, the largest increase up until that point, but it also contained nearly \$500 billion in deficit reduction over the next 5 years. Additionally, it created enforcement procedures in the Budget Enforcement Act (BEA) which helped lead to budget surpluses in the late 1990's. The BEA also created adjustable caps for separate categories of discretionary spending, both domestic and defense, and the pay-as-you-go (PAYGO) procedure that required tax cuts or increases in mandatory spending to be paid for. The final budget resolution plus the reconciliation and appropriations bills were passed with bipartisan votes in both the House and Senate. They laid the critical groundwork that led to a balanced budget.

5. The Omnibus Budget Reconciliation Act of 1993 (OBRA '93)

As OMB Director to President Clinton, the President was committed to further reducing the federal deficit, which was still rising at a dangerous pace. Although an effort was made to get Republican support, it was made clear that since Democrats had opposed Republican efforts to reduce the costs of Social Security and made it a political issue, the Republicans would not support the Clinton budget. The budget passed narrowly with Democratic votes and it led to the Omnibus Reconciliation Act of 1993 which provided \$504 billion in deficit reduction, surpassing the 1990 agreement's deficit reduction level of \$496 billion. Cuts totaled \$102 billion in discretionary spending and continued caps on both discretionary and defense spending, and close to \$150 billion in entitlement savings. Income taxes were raised on the top 1% and the top tax rate was raised to 39.6%. Over Clinton's term, deficits went from a 3.8% of GDP (\$225 billion) deficit to a 2.3% of GDP (\$236 billion) surplus in 2000. Debt fell from 48% of GDP to 34% of GDP.

6. Balanced Budget Act of 1997

Returning to bipartisanship on the budget, the Balanced Budget Act of 1997 included a \$450 billion debt limit increase and continued the budget savings in the 1990 and 1993 budget agreements. It did add \$125 billion of net deficit reduction over 5 years through reductions in health care spending via provider payment reductions and increased premiums.

As a result of all of these deficit reduction efforts, the budget came into balance in FY1998. The anticipated budget surpluses were on track to pay off the public debt by 2009 or 2010.

Why the Current Budget Process is Broken

1. Lack of bipartisanship and regular order

The budget process worked when there was bipartisan support for the need to pass a Budget Resolution, and the Budget Committee Chairmen and ranking members worked together in the



Committee process to develop compromises. As Congress became increasingly partisan over the last 15 to 20 years, both parties viewed the budget process as an unnecessary and bothersome discipline to achieving their partisan goals. Regular order was bypassed and the budget process was easily ignored. When the Presidents and Leadership of both parties failed to restore order, spending and deficits went out of control.

2. Lack of support for enforcement

Senate PAYGO rules have been waived 14 times since 1993. The 2001 Tax Cut of \$1.35 trillion, the Medicare prescription drug program costing \$400 billion, the capital gains tax cut of 2003, spending on the wars in Iraq and Afghanistan, the \$800 billion fiscal stimulus bill, the \$620 billion tax cut bill of December 2015, the \$1.8 trillion tax bill in December of 2017, and the \$300 billion increases in appropriations spending agreed to in February were not paid for and added to the deficit. The House voted 228 to 188 for the rule that allowed the CR to contain the PAYGO waiver for the December tax bill. The Senate voted 91 to 8 to waive the points of order against the waiver.

3. Reliance on crises to drive deals and appropriations

In our democracy, we govern either by leadership or crisis. If leadership is not there, we will inevitably govern by crisis. We have had 3 major budget deals in the past 5 years (BBA 2013, 2015, and 2018) two of these came after government shutdowns. In 2013, there was a 16-day shutdown, it was ended with a 2-month CR, which allowed the then chairs of the Budget Committees, Paul Ryan and Patty Murray, to work out the Bipartisan Budget Act of 2013. In 2018, there was a brief 3-day shutdown in January before a 3-week CR. The Bipartisan Budget Act of 2018 followed that CR. The Congress has become increasingly prone to needing crisis in order to resolve budget and appropriations issues. The result is that rather than resolving these issues, it has become politically more expedient to simply kick the can down the road, waiting for the next crisis to drive yet another temporary solution.

4. Misuse of reconciliation to add to rather than reduce deficits

The Conrad rule prevented deficit increasing reconciliation from 2007 to 2015, by establishing a 60-vote point of order against reconciliation legislation that increased deficits inside the budget resolution's window. The budget resolution that allowed the December tax bill to move through the reconciliation process allowed up to \$1.5 trillion in higher deficits. The 2018 Budget Resolution was another good example of how deficit reduction is swept aside for political convenience. The original House Budget Resolution called for reconciliation instructions to multiple committees to achieve at least \$200 billion in savings. When it became apparent that reconciliation was to be used for tax cuts, a new budget was passed with reconciliation instructions for \$1.5 trillion of deficit increases for tax cuts, and a token amount of savings.

5. Little respect for the discipline of budget process

There is an April 15 deadline by which Congress is supposed to complete the budget resolution but that deadline is often missed. The last time a budget resolution was completed on time was in 2003 for the FY2004 budget. This year again appropriations bills are moving without a budget. Congress has only met the budget deadline 6 times: 4 times when the deadline was April 15 and



twice when the deadline was May 15 before 1986. More often, the Congress had created the budget deadline as a deadline for one chamber or the other to pass a budget. Out of the 43 years between FY 1976 and 2018, the House has failed to vote on a budget by the deadline 13 times and the Senate 18 times. In the early years of the budget process, the Leadership placed a great deal of pressure on the Budget Committees to meet their deadlines. Without pressure from the leadership, deadlines are worthless.

Recommendations for Budget Process Reforms

1. Biennial Budget Resolution and Joint Budget Resolution

Biennial budgeting would allow the budget timeline to match the election cycle. Each new Congress could create a budget without having the same fiscal battles twice, allowing for a “mini-resolution” that could make any necessary adjustments in the second year. The precedent has been set by recent budget deals that are for 2 years. That would allow 1 year to set the budget and a 2nd year to do greater oversight of spending.

A joint budget resolution would bring the President into decisions about discretionary spending levels, mandatory spending reform, tax policy and deficit reduction targets early in the process. This would encourage negotiations at the beginning of the budget cycle, providing greater certainty for the appropriations process. Should the President veto the joint budget resolution, a fall back mechanism could be provided that would set enforceable spending and revenue levels based on the joint resolution to allow the budget process to move forward. Policymakers would take the budget more seriously if it was the result of serious upfront set of negotiations with the President. If the President agreed to the targets, the budget would carry greater weight and if not, the Congress would be forced to protect its credibility by enforcing its own limits and targets.

2. Change federal fiscal years to calendar basis

Using the calendar year as the fiscal year would help avoid the present pattern of constant budget crisis and CRs by giving more time for lawmakers to complete the budget process after taking office. Having said that, it should be noted that no amount of process reforms will help if lawmakers are not sufficiently committed to taking it seriously. When Congress moved the Fiscal Year start to October 1 rather than July 1, they were able to do appropriations on time for the first year but missed the deadline in the second year and for 37 of the 40 years after that.

3. Prohibit legislation with fiscal impact if no budget resolution is adopted and enforce with a super majority point of order in Senate

Congress should not make policy affecting the budget without first writing and approving a budget resolution. The Senate should establish a super-majority point of order against legislation with a fiscal impact considered during a fiscal year for which no budget has been passed. Additionally, members of Congress should not be allowed to leave for a Congressional recess if a budget resolution has not been passed.



4. Debt ceiling should be lifted by passage of Budget Resolution (Gephardt Rule) or by the President if Congress fails to act

When I was Chairman of the House Budget Committee, the so-called Gephardt Rule was adopted providing that “when Congress adopts a budget resolution, spinoff legislation providing for a debt limit increase is deemed to have passed as well.” The increase was to be set equal to the debt under the budget at the end of the fiscal year so that the final increase in the debt limit enacted into law reflects the level of debt assumed in the budget resolution consistent with the spending and revenue policies in the budget. Unfortunately, the Gephardt rule was repealed in the 107th Congress, restored in the 108th, and then repealed again in the 112th Congress in 2011.

In the absence of Congressional approval, the President should be given the authority to raise the debt limit to take into account spending that has already been approved by Congress and signed by the President. Increases in the debt limit based on spending is critical to the good faith and credit of the United States.

5. Prevent budget gimmicks—“rosy scenario”, “magic asterisks”, timing shifts, double counting, etc.

“Rosy Scenarios”—often, budget resolutions use overly optimistic economic assumptions to create additional revenues to support spending or reflect greater savings. This should be limited by requiring budget resolutions to use CBO’s baseline and economic assumptions.

“Magic Asterisks”—these refer to unspecified, and perhaps unachievable, budgetary savings assumptions to obscure large deficits that would result from the budget. This should be limited by requiring reconciliation instructions for all changes to mandatory spending and revenue assumed in the budget.

Timing Shifts—to hide costs, Congress has often changed the dates for tax and entitlement payments from one fiscal year to another. Congress should prohibit timing shifts and disallow the use of mandatory or revenue ten year offsets without long term savings unless they are used for truly temporary policies; and further disallow the use of Changes in Mandatory Programs (CHIMP’s) that shift current year Budget Authority (BA) to future years.

Trust Fund Double Counting—either all trust fund spending should be assumed to be limited by trust fund resources or none should. In addition, policymakers should require transfers into trust funds to be counted as a cost for enforcement purposes and allow trust fund savings to be used as an offset only if savings are transferred to the general fund.

6. Enforcement of pay-as-you-go, discretionary caps and other enforcement measures with strong points of order

Members of the House should be able to make a point of order if legislation adds to the deficit and is not paid for. CBO should score all legislation with regard to its impact on the deficit. The Senate vote threshold should be raised above 60 votes to waive PAYGO rules and all Budget Act



points of order. A threshold above 60 for fiscally irresponsible legislation would create a meaningful hurdle to cross.

7. Require Congress and the President to use the same baseline

When I was Director of OMB, there was an effort to reconcile a common baseline between OMB and CBO in order to avoid baseline manipulation based on more optimistic growth rates or other economic projections. Unfortunately, that effort did not continue. Having consistent conventions and assumptions would help streamline budget development and lead to more efficient and transparent policymaking.

8. Place controls on discretionary emergency spending

Congress should set and establish a budget for emergencies to avoid the habit of adding to the deficit for crises of one kind or another. Waivers can be provided for extraordinary emergencies but providing an emergency fund within the budget would help support the additional aid without continuing to add to the deficit. Defense OCO funding should also be brought within the budget particularly after a military conflict has persisted for a number of years.

9. Budget and establish controls for mandatory spending and tax expenditures, and prevent reconciliation from being used to increase debt

The budget should establish targets for mandatory spending and tax expenditures so as to better discipline spending in these areas. Congress should establish multi-year budgets for mandatory spending programs and tax expenditures and require regular review of both. No part of the budget should be on “autopilot” without a process of reviewing the policies and expenditures associated with spending and tax expenditures.

It is critical that the budget process go back to the original intent of the Budget Act that reconciliation be used for deficit reduction. The “Conrad rule” should be restored and codified. Too often, reconciliation has been used simply to avoid the Senate filibuster for legislation that would dramatically expand the budget deficit. Particularly now with deficits approaching \$1 trillion and the national debt over \$20 trillion, reconciliation should be used to achieve savings and raise revenues, not add to the deficit and the debt.

10. Require 10-year estimates in budgets

Today, budgets are only required to cover 5 years although CBO and recent budgets have provided for a 10 year window. Policymakers need to understand the fiscal impact of major spending and tax proposals not just within the current 5 year window, but also over a longer 10 to 20 year budget horizon. Such proposals often have dramatic budgetary effects in the second decade and beyond.



Bipartisan Political Leadership and the Need for a Comprehensive Budget Agreement

While the above recommendations would help strengthen the budget process itself, the fact remains that without bipartisan support, budget reforms will not only not work, there is a good chance that none will be approved. History tells us that the budget process worked effectively when both political parties were willing to work together, compromise and support difficult budget decisions. A balanced budget was achieved because both Democrats and Republicans were willing to take the political risks essential to disciplined budgeting.

The simple fact is that if partisanship prevails, no party will be willing to deal with all the elements of a budget critical to effectively reducing the debt. Perhaps what is needed to lay the groundwork for budget process reforms is agreement on a Bipartisan Commission that would recommend a comprehensive 10 year deficit reduction package, including discretionary and defense caps, entitlement savings and additional revenues. If such a package were agreed to, budget process reforms would easily be added to enforce the agreement. That was the case in the Omnibus Budget Reconciliation Act of 1990. In the absence of a comprehensive budget agreement, it will be difficult to approve budget reforms without a budget to enforce.

How Congress Should Proceed Without a Budget Agreement

Assuming that the parties are unable to agree on any kind of comprehensive budget agreement, it will be difficult but not impossible to adopt budget reforms.

1. Joint Select Committee report requires bipartisan support

By the law establishing the JSC, there must be a majority of the Republicans and a majority of the Democrats to approve the Committee's final report. Such a bipartisan report would be an important first step.

2. Support of the bipartisan House and Senate Leadership

It would be critical to have both the support of House and Senate Leadership for passage of the budget reforms. Members will cast tough votes on reforms if the leadership is willing to provide political cover.

3. Support of the House and Senate Budget Committees and House and Senate Appropriations Committees

4. Adopt BRAC process for adoption of needed budget reforms

Although the JSC recommendations have some fast track status, it would be better to incorporate BRAC requirements that force an up or down vote on the entire set of recommendations. Some of these recommendations will be controversial, particularly from those opposed to a strong budget process. Since the leadership placed their trust in the members of the Joint Select



Committee, those recommendations should be voted upon in block and not subject to amendment.

Summary

In summary, at the heart of the budget process is the future fiscal health of the nation. The current CBO projections are that the deficit will exceed \$1 trillion and continue to grow and that the federal debt will go from 78% of GDP by the end of 2018 to over 152% of GDP in 2048. That size debt will seriously jeopardize and undermine the American economy. It will lead to slower economic growth, lower income, higher interest rates, ballooning interest payments, reduced fiscal space, weakened international leadership and increased likelihood of financial crisis. The U.S. will not be able to respond to economic crisis. Interest on the debt will spin out of control...leading to a "death spiral" of deficits and debt. We will not be able to make critical investments in our security and our people. It is not a responsible or moral position to hand down a massive debt to the next generation.

The bottom line is that the country cannot afford to have a budget process that is a game played or not played based on the political pressures of the moment. The Budget Process and the difficult decisions that are related to the future of the budget are critical to the economic future of the nation. As I have made clear, we govern in our democracy through leadership or crisis. In the absence of leadership, the budget process has largely operated by crisis. Nothing will change unless the political leadership of both parties are willing to take risks for the sake of the country. Process reforms can help but frankly without the courage to make the difficult decisions on spending and revenues, process reforms will not be enough.

I commend the work of the Joint Select Committee for making this effort and strongly support the reforms essential to restoring budget discipline. But the real test will be when both the House and Senate pass Budget Resolutions and Reconciliation that dramatically reduce the deficit over the next 10 years. When that happens, and those steps are enforced by an effective and efficient budget process, the work of this Joint Select Committee will truly have served the interest of the nation.