# Committee for a Responsible Federal Budget




## *Testimony of Maya MacGuineas*
## *Committee for a Responsible Federal Budget*

## Hearing before the House Budget Committee: Setting a Fiscal Goal

### June 15, 2016

Chairman Price, Ranking Member Van Hollen, and Members of the Committee, thank you for inviting me here today to discuss the important topic of how we can best budget for the future and the role of using a fiscal goal. The fiscal challenges we face are significant, and I appreciate the opportunity to discuss the types of reforms that can move us toward a healthier economy.

I am Maya MacGuineas, president of the Committee for a Responsible Federal Budget and head of the Campaign to Fix the Debt. The Committee for a Responsible Federal Budget is a non-partisan organization dedicated to educating the public about and working with policymakers on fiscal policy issues. Our co-chairs are Purdue University President and former OMB Director Mitch Daniels, former Secretary of Defense and former OMB Director Leon Panetta, and former Congressman Tim Penny. Our board includes past directors and chairs of the Office of Management and Budget, the Congressional Budget Office, the Federal Reserve System, the Treasury Department, and the Budget Committees. Our partner organization, Fix the Debt, is a nonpartisan movement that mobilizes key communities – including leaders from business, government, policy, and academia – who believe lawmakers must work together to deal with the nation's fiscal challenges to help protect our citizens and grow the economy. The group is chaired by Senator Judd Gregg, Mayor Mike Bloomberg and Governor Ed Rendell.

I will make several main points today:

1. Our deficit and debt problems are far from solved
2. There are many advantages to getting the debt to more manageable levels
3. Having a fiscal goal is a key part of budgeting
4. A fiscal goal should be aggressive enough to help fix the problem but realistic enough to be achievable
5. A fiscal goal should be accompanied by procedures to achieve goal and stay on track
6. A fiscal goal should include enforcement mechanisms, which can be done through carrots or sticks

## Our deficit and debt problems are far from solved

At $14 trillion, or 75 percent of Gross Domestic Product (GDP), the national debt held by the public is currently near record levels. As a share of the economy, that is higher than any time other than around World War II, and is nearly twice the 50-year historical average.

Even more concerning, the aging of the population and growth in health costs mean that debt is projected to grow unsustainably in the coming years. According to CBO, debt under current law will reach 86 percent of GDP in 2026 and exceed the size of the economy by 2033. The debt is projected to grow faster than the economy indefinitely, which is obviously not sustainable.

Although deficits have declined by 70 percent in recent years—a point many who are not keen on focusing on our long-term fiscal problems like to point out—that decline followed a nearly 800 percent increase; and trillion-dollar deficits are projected to return again by 2022.

As deficits and debt continue to rise, the result will be slower wage growth, higher interest rates, larger interest payments as part of the budget, and reduced flexibility to deal with new crises or pursue new opportunities. As CBO has explained, "To avoid the negative consequences of high and rising federal debt and to put debt on a sustainable path, lawmakers will have to make significant changes to tax and spending policies—letting revenues rise more than they would under current law, reducing spending for large benefit programs below the projected amounts, or adopting some combination of those approaches."[1]

The sooner we act to begin addressing the debt, the better. Yet there seems to be a near endless list of shortsighted *political* excuses about why we should not do anything to get our debt under control. Meanwhile, our interest payments continue to grow faster than any other part of the budget, our entitlement programs are headed toward insolvency, and the size of the necessary fixes get larger by the day.

## There are many advantages to getting the debt to more manageable levels

There are many important benefits to getting our debt under control:

- **Greater Investment and Economic Growth.** Lower government debt means less savings will be put toward government bonds and more toward productive private investments. Lower debt can increase capital stock, wage growth, and GDP growth. According to CBO, reducing and stabilizing the debt at about 65 percent of GDP by enacting $4 trillion of *primary* deficit reduction over the next decade will increase the size of the nominal economy by roughly 2.5 percent by 2040. Balancing the budget by enacting nearly $8 trillion of *total* deficit reduction will increase the economy per person by roughly 4 percent by 2040.[2]

---

[1] CBO, *The Budget and Economic Outlook: 2016 to 2026*, January 2016, p. 33
[2] CBO, *Budgetary and Economic Outcomes Under Paths for Federal Revenue and Noninterest Spending Specified By Chairman Price*, March 2016.

- **Higher Income and Wages**. Faster economic growth translates to higher average incomes. Using CBO's rules of thumb, we calculate that a balanced budget would increase per-capita GNP (or very roughly average income), by over 6 percent more in 2040, relative to following current law. In today's dollars, that's almost a $5,000 annual wage increase per person. And over the next 25 years, it represents roughly $45,000 of additional income for an average worker. For a scenario of $4 trillion in deficit reduction over ten years it is nearly 4 percent higher income representing a $3,000 annual increase by 2040. In all it would increase income by roughly $28,000 over the same period.
- **Lower Interest Rates.** Growing national debt can drive up interest rates throughout the economy, leading to higher interest payments on mortgages, car loans, student loans, and credit card debt. By our rough estimates, projected interest rates would be roughly two-thirds of a point lower if debt were stabilized at 65 percent of GDP and 1 point lower if the budget were brought into balance. These lower rates would flow through the whole economy. For example, a 1 point reduction in the interest rate would mean a family with a $300,000 mortgage could expect to pay at least $60,000 less over the course of the mortgage.
- **Additional Resources Due to Declining Government Interest Payments.** Interest payments are projected to grow from $225 billion last year to more than triple to about $840 billion in 2026. That means the government will spend more on servicing its debt than it will spend on national defense or Medicaid. Even before accounting for the effects of lower interest rates, stabilizing the long-term debt at 65 percent of GDP would reduce interest payments by $150 billion in 2026 while balancing the budget would reduce them by $250 billion. That would mean much more space to address other important priorities.
- **Increased Ability to Respond to Problems.** Governments often borrow to address unexpected events, like wars, financial crises, and natural disasters. This is relatively easy to do when the federal debt is small as a share of the economy, as for instance it was when we went into the 2008 crisis. However, with a large and growing federal debt, the government has fewer options available. Now the debt is more than double what it was in 2007 as a share of GDP and we could be dangerously constrained were we to face another crisis while debt is this high.
- **Reduced Risk of Fiscal Crisis.** If the debt as a share of the economy continues to climb, at some point investors will lose confidence in the government's ability to pay back borrowed funds. Investors would demand higher interest rates on the debt, and as a result interest rates could rise sharply and suddenly, creating a debt crisis, as we have seen in other nation's when their debt is no longer manageable. While there is no sound mechanism for determining if and when a fiscal crisis could occur, CBO warns that, "the larger a government's debt, the greater the risk of a fiscal crisis."[3]

[3] CBO, *The 2014 Long-Term Budget Outlook*, July 2014, p. 15.

## Having a fiscal goal is a key part of budgeting

Fiscal goals help keep the budget on a sustainable path and they help force the critical budget discussion of dealing with trade-offs. Although the terms fiscal goal and fiscal rule are often used interchangeably, for purposes of my testimony, a fiscal goal is a numerical target over a long-lasting time period to guide fiscal policy and fiscal rules are the mechanisms to ensure compliance with the fiscal goal.

Without an effective and enforced fiscal goal, policymakers can always choose to borrow for any tax cut or spending initiative. Policymakers are not forced to prioritize or determine if something is worth the cost. Spending and tax cuts are popular while spending restraint and tax increases are not. A fiscal goal can provide countervailing pressure to the appeal of spending increases and tax cuts.

Having a goal—whether it is balancing the budget by a certain date, or getting the debt to a specific level or share of the economy in a certain amount of time—forces policymakers to show their preferred paths for achieving the goal, which in turn would lead to the discussion of the various trade-offs of different approaches. That is supposed to be a core principle of budgeting.

Numerous international and domestic examples show the power of having fiscal goals enforced by fiscal rules. The Committee for a Responsible Federal Budget previously published a paper "Fiscal Turnarounds" that showed "Credible fiscal rules and fiscal goals… helped policymakers and taxpayers maintain discipline" in five countries that turned around large deficits and debt: Canada, Denmark, Finland, Ireland, and Sweden.[4]

In most instances, fiscal rules were adopted at the same time as a fiscal consolidation package to ensure that the fiscal goals of the consolidation package were met. Imposing fiscal rules to accompany a fiscal consolidation package enhanced the credibility of the package and brought greater payoff in the long run. We found that these fiscal turnarounds had several common features:

- Large, multiyear adjustments have been more successful in terms of both fiscal outcomes and economic results.
- Successful packages generally tackled structural tax and spending problems such as a narrow tax base or underfunded entitlements.
- Public dialogue can play a critical role in building support for a fiscal consolidation package.

The experience with fiscal rules in other countries shows that not only can setting a goal increase public understanding of a country's fiscal position—by providing a simple to understand benchmark—but can also serve as a spur to policymakers to act promptly to address fiscal threats

[4] CRFB, *Fiscal Turnarounds*, February 2010, http://crfb.org/sites/default/files/Fiscal_Turnarounds.pdf

by adhering to the goal, or prevent such actions that are tempting but would lead to a violation of the goal. A fiscal goal can serve as a guide post to get back to fiscal health after an economic downturn or other factors that may force rule violation. Fiscal rules can enhance transparency, help provide a measure of accountability, and bolster the credibility of a central government in the eyes of its citizens. Fiscal rules can help policymaker's subordinate shorter-term concerns to longer-term fiscal objectives.

It is worth noting that while the experience of other countries can help guide U.S. policymakers, the U.S. political system is unique. In many countries that have successfully implemented a fiscal rule the executive or executive branch equivalent can implement fiscal policy with little or no input from the equivalent of the U.S. Congress. Regardless, international experiences with fiscal rules can be insightful for U.S. lawmakers.

The International Monetary Fund (IMF) has identified four types of fiscal rules which can be established independently or in combination:

- **Balanced budget rules** can specify overall balance, structural or cyclically adjusted balance, balance over the business cycle or primary balance excluding interest costs. The "golden rule" targets overall balance net of capital expenses. While overall balance or structural balance will help reduce the debt to GDP ratio, a goal of primary balance or the golden rule may not lead to sustainable debt levels. Cyclically-adjusted rules are superior in dealing with economic shocks, but pose challenges in accurate assessment of the cyclical position and in communication with the public.

- **Debt rules** set an explicit limit or target for public debt as a percentage of GDP. Debt rules by definition are the most effective tool in ensuring sustainable levels of debt.

- **Expenditure limits** set limits on total or primary spending in absolute terms, growth rates or a percentage of GDP. Expenditure limits do not necessarily lead to sustainable levels of debt since they do not address the revenue side of the budget. However, they can be a useful tool to trigger necessary changes to achieve sustainability, especially when combined with debt targets.

- Finally**, revenue rules** can set ceiling or floors on revenues to boost revenue levels or prevent excessive tax burdens. Revenue rules likewise do not necessarily lead to sustainable levels of debt because they do not constrain the spending side of the budget, but can be a tool to force changes in tax policy to help meet a debt goal.

An IMF report issued in December 2009 highlighted the growing use of fiscal rules – now used in 80 countries, compared to only seven countries in 1990. Among the IMF's general findings on the use of fiscal rules:

- Beginning in the 1970s many countries, including the U.S., looked to fiscal rules to help rein in rapidly accumulating debt. (Our rules included deficit targets under Gramm-Rudman and PAYGO rules and discretionary spending limits in the 1990 Budget Enforcement Act.)

- The use of fiscal rules increased in the 1990s as a number of countries' debt raised alarm.

- Over time countries have gravitated toward using a combination of rules that are often linked to debt sustainability; in recent years, however, the goal of simply restricting the size of government has become a more frequent objective.

- Budget balance and debt rules are the most common, with about 60 percent of the countries studied employing one or the other or both. Cyclically-adjusted and structural balance rules remain rare but are becoming more common.

- The use of fiscal rules is on average associated with improved fiscal performance.

- Fiscal rules are often introduced to lock-in earlier consolidation efforts.

**Figure 1: Major International Fiscal Rules**

| Country | Fiscal Rules | Statutory Basis |
|---|---|---|
| UK | Overall surplus by 2020 | Legal "Mandate" |
| | Debt falling every year from 2015-20 | |
| Germany | Structural deficit of less than 0.35% of GDP | Constitution |
| | Overall deficit of less than 3% of GDP | EU Treaty |
| | Debt below 60 % of GDP | |
| Sweden | Overall surplus of 1% of GDP over the economic cycle | Primary Legislation |
| Norway | Non-oil deficit less than 4% of GDP every year | Political Commitment |

**Source: IMF**

The debt goal could apply to the upcoming fiscal year, or to a rolling five-year period. The latter approach would allow Congress and the President to enact policies that gradually reduce debt below the cap by the end of the five-year period. A similar policy exists in Switzerland where a statutory debt brake limits spending growth to the average revenue increases over a multiyear period. This ensures on average spending won't grow faster than revenue.

In a December 2010 report, "***Getting Back in the Black***", the Peterson-Pew Commission convened by CRFB recommended adopting a fiscal rule as part of our comprehensive set of proposals to reform the federal government's budget process. As we said then, "experience of some other countries with systems of fiscal rules such as we recommend shows that they can help leaders sustain policy agreements consistent with long-term stability, provided that they take into account the uncertainties inherent in constructing budgets and are therefore not unrealistic or too rigid." The specific fiscal goal of the commission was to reduce the debt-to-GDP ratio to 60 percent in the medium term while balancing the budget over the business cycle in the long term. Yet less important than the specifics was the existence of an agreed-upon goal.

A fiscal rule can be an important means of ensuring fiscal discipline. If taken as a credible commitment with procedures and enforcement mechanisms to ensure compliance with the rule, it serves as a reassurance to leaders, voters, creditors and financial markets generally of a stable basis for their own decisions.

A debt or balanced budget goal could be accompanied by spending and revenue goals that are consistent with the debt or budget balance rule. Setting spending and revenue goals would allow policymakers to decide the tradeoffs between spending and revenues necessary to meet the debt or deficit goal, which could help in reaching agreement on the overall fiscal goal.

Spending targets could be divided further among major types of spending, perhaps with separate limits on discretionary and mandatory spending or possibly dividing further with separate targets for health entitlements and other major categories of mandatory spending. Establishing separate spending and revenue goals would allow fiscal rules to target the cause of any violation of debt or deficit targets – if the debt or deficit target was missed because spending exceeded the target, fiscal rules would focus on corrective action on the spending side and if the goal was not met because revenues fell short of the target fiscal rules would focus corrective action on the revenue side.

In establishing a spending goal, policymakers must balance the increased demand on and growth in spending on mandatory programs with the aging society against the reality that it is not sustainable for total spending to continue to grow faster than GDP indefinitely. Likewise, the choice of a revenue target must take into account the increased demands on the budget with the aging society while setting targets that are economically and politically viable.

Establishing revenue targets enforced by fiscal rules would allow policymakers to responsibly use dynamic scoring to meet fiscal goals. Policymakers could enact tax reform legislation that is projected to produce increased revenues as a result of stronger economic growth, with the revenues projected under dynamic scoring enforced by a revenue target. If the projected revenues from economic growth did not materialize, fiscal rules could provide for corrective action to bring revenues up to the projected levels. Conversely, a fiscal rule related to revenues could allow for legislative action reducing taxes if actual revenues exceeded the targets.

## A fiscal goal should be aggressive enough to help fix the problem but realistic enough to be achievable

Right now, looking at the budget projections, it appears that the implicit fiscal goal Congress has chosen is starting at near record debt levels, and adding roughly $10 trillion to the debt over the next ten years. This would result in a deficit of $1.3 trillion in 2026 and a debt level equivalent to 86 percent of GDP. While reasonable people will disagree on what the best goal is, almost no one would choose our current path. I propose we choose another goal.

A reasonable fiscal goal would first and foremost stop the debt from growing unsustainably, and then begin to reduce debt levels relative to the economy.

However, there is no singular “right” level of deficits or debt, so there is no “right” fiscal goal. A reasonable fiscal goal should be aggressive enough to improve our fiscal situation and put the debt on a sustainable path but not so aggressive as to be unachievable. Establishing a fiscal goal that requires more savings than policymakers are willing or able to enact will lead to an erosion of the credibility of the fiscal goal as the targets are missed. In other words, an unrealistic fiscal goal is unlikely to be an effective fiscal goal.

For example, Congress adopted a budget resolution last year that set a goal of balance within ten years but failed to enact the deficit reduction assumed in the resolution to achieve that goal. In fact, Congress enacted legislation which increased the deficit by roughly $1 trillion over ten years. Establishing a fiscal goal without the political will to follow through on the choices necessary to meet the goal resulted in a complete breakdown in fiscal discipline. It would be better to establish a fiscal goal that is not as aggressive but which policymakers are willing to enforce.

The charts below outline some examples of potential fiscal goals and approximate amount of 10-year deficit reduction needed to meet each goal:

**Figure 2: Savings Needed to Achieve Various Fiscal Goals**

| Fiscal Goal | Proposed By | 10Y Deficit Reduction Needed | Debt in 2026 (Percent of GDP) | Deficit in 2026 |
|---|---|---|---|---|
| Balance the Budget in 10 Years | House Budget Committee | $8 trillion* | 58%* | $0 |
| Balance the Budget in 20 Years | Illustrative | $6-7 trillion* | 62%* | $210 billion* |
| Balance the Budget in 30 Years | Illustrative | $4-6 trillion* | 67%* | $450 billion* |
| Balance the On-Budget (Excluding Social Security) in 10 Years, Social Security Solvency | Kasich | $6 trillion* | 65%* | $333 billion |
| Reduce Debt to 60 Percent GDP in 10 Years | Peterson-Pew | $7.1 trillion | 60% | $110 billion* |
| Reduce Debt to 60 Percent of GDP in 20 Years | Illustrative | $5 trillion | 67% | $460 billion |
| Reduce Debt to 70 Percent GDP in 10 Years | Simpson-Bowles | $4.3 trillion | 70% | $590 billion* |
| Stabilize Debt at Today’s Level (75 Percent of GDP) | Obama | $2.9 trillion | 75% | $830 billion* |

*Notes: Total deficit reduction includes interest.*
**Numbers based on illustrative paths and could vary significantly depending on details*

Setting a goal of a balanced budget has the advantage of being a simple, clear goal that is easily understood by the public. Achieving balance in ten years as the budget resolution reported by the Budget Committee earlier this year would require approximately $8 trillion in deficit reduction (including interest) over the next ten years. A more modest goal would be to balance the non-Social Security budget, perhaps combined with a goal of long-term solvency of the Social Security trust fund. That was the goal set out by Governor John Kasich in his presidential campaign. Achieving that goal would require approximately $6 trillion in deficit reduction over the next ten years.

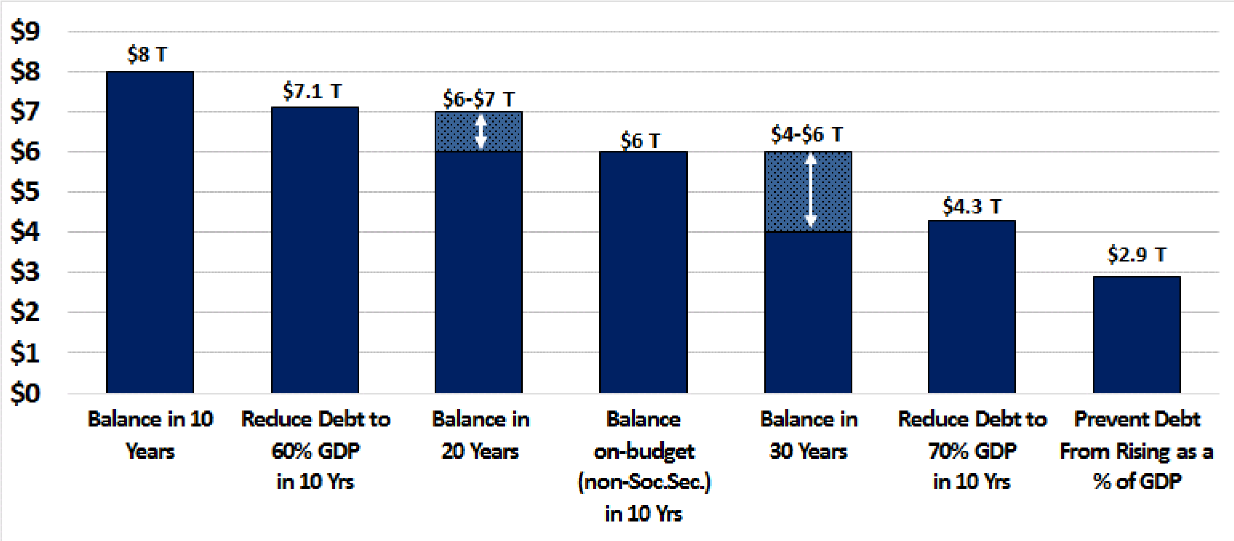
Setting a goal of balance in twenty or thirty years would require somewhat less deficit reduction, but not significantly so because the deficit is projected to rise rapidly beyond the ten-year window. Depending on the exact phase-in of deficit reduction, achieving balance in twenty years would require $6-7 trillion in savings over the next decade and achieving balance in thirty years would require $4-6 trillion in deficit reduction over the next decade.

A goal with more flexibility would be to balance the budget over the business cycle, running surpluses when the economy is strong to offset deficits when the economy is weak. A related goal would be to eliminate the structural deficit excluding the costs of automatic stabilizers. Although putting the budget on a path to achieve those goals would require roughly the same amount of deficit reduction as a fixed balanced budget goal, it would provide more flexibility in achieving and sustaining the goal if the economy is weaker than currently projected.

From an economic perspective, the most meaningful measure of our fiscal health is the share of debt held by the public as a percentage of GDP and its trajectory. It therefore may make sense to choose a fiscal goal setting a target for debt as a percentage of GDP. Simply stabilizing debt at current levels, as the President's budget proposed to do, would require $2.9 trillion in savings. But with debt is at the highest levels since the end of World War II, I would argue strongly this fiscal goal is not sufficient.

Reducing the debt below 70% of GDP within the decade, as the revised plan put forward by Erskine Bowles and Alan Simpson in 2013 proposed to do, would require $4.3 trillion in deficit reduction over the next decade. Reducing the debt to 60% of GDP within ten years, as the Peterson-Pew Commission recommended in 2010 when the debt was 62% of GDP, would require now $7.1 trillion in deficit reduction.

**Figure 3: Fiscal Goals 10-Year Deficit Reduction Needed (in trillions)**




**Source: CRFB Calculations**

The reality is that balancing the budget is probably not in our immediate future. Our projected deficits are too large for us to reach balance in the very near future without making some extremely difficult choices about what spending to cut and/or taxes to raise.

A goal for the federal budget today may need to be more forward-looking and possibly long-term. It would be coupled with fiscal targets for deficit and/or debt targets that put the budget on a path to comply with the ultimate fiscal goal when it takes effect.

If the U.S.'s goal is to achieve fiscal sustainability as soon as possible, then a debt rule requiring that federal debt be stabilized and put on a declining path by a specific year may be appropriate in the interim. Such a rule would have several advantages: it includes a clearly defined, readily computable target; is easily described to the public; and is substantively important in the near term as a way to quantify the budget savings required to reach stability.

Whatever goal is adopted, the status of the U.S. and world economy suggests using a careful approach to implementation. Establishing a goal that would begin to take effect gradually and that allows deficit reduction to be phased in over time would be the more responsible approach.

A poorly designed fiscal rule could have a negative effect at exactly the time when a country's economy is struggling the most. A properly designed fiscal rule should include a mechanism to suspend, waive, or delay it in the face of economic weakness. Escape clauses are most commonly designed to respond to national disasters or wars, or a severe economic downturn or financial crisis. Careful design of escape clauses is important to avoid their abuse as a way to circumvent fiscal rules. The use of emergency spending waivers of normal budget procedures in the U.S. has been a popular method of exceeding spending limits or other budgetary restraints.

We recommend establishing a fiscal rule with flexibility to modify or suspend the goal if certain economic conditions such as low economic growth or high unemployment are met, with provisions to offset higher deficits when the economy recovers. This could also be achieved by setting a fiscal goal of balance over the business cycle or balance of the structural deficit excluding effects of automatic stabilizers.

Normally our group worries about politicians pushing hard choices into the future and then never really doing them. But in our current situation, I would accept savings that are phased in gradually and achieve modest savings in the near term to make more progress on the future imbalances we face as a result of continued structural deficits, growing healthcare costs, the aging of the population, and growing interest payments. A strong fiscal rule setting medium and long-term targets with a credible enforcement mechanism would provide political space for such a tradeoff.

The Peterson-Pew Commission of Budget Reform made a point in "*Red Ink Rising*", suggesting that "the 'announcement effect' of such a commitment [to a goal], if credible, can have positive economic effects by signaling that the United States is serious about reducing its debt." Experience in many foreign countries, including those in the EU that adopted the euro, suggest that advance announcements of what economists call a "medium-term fiscal consolidation plan"[5] can have a beneficial impact on the economy by creating positive expectations related to challenging debt problems. This, in turn, would translate into a stronger financial position for the U.S. and savings for the taxpayer.

Implementation of and adherence to a fiscal goal requires a good deal of political will. Adherence to any strong fiscal rule depends on whether it is grounded in consensus among policymakers and the public about what constitutes sound fiscal policy. The traditional consensus that supported federal fiscal discipline in the past has evaporated. Therefore, the first task of U.S. leaders prepared to bind themselves to a fiscal goal is to help restore a national norm of fiscal responsibility. Otherwise, any rule will succumb to the siren call of urgent demands for government to do more than it is prepared to pay for.

## Procedures for achieving a fiscal goal and staying on track

Setting a fiscal goal policymakers can agree on is an important first step. But simply setting the goal is of little value if lawmakers are not working toward that goal. Indeed, establishment of a fiscal goal that is not accompanied by rules to ensure compliance could make action less likely by allowing lawmakers to take credit for supporting a fiscally responsible goal without voting for changes in tax and spending policies to achieve the goal. To reinforce the fiscal goal, it is essential that it be accompanied by fiscal rules to enforce the goal. While process is not a substitute for political will, putting in place budget rules and procedures to steer policymakers toward a fiscal goal can be extremely helpful.

---

[5] Peterson-Pew Commission on Budget Process Reform, R*ed Ink Rising: A Call to Action to Stem the Mounting Federal Debt*, December 2009, p. 8.

Ideally, fiscal rules would be put in place to accompany a deficit reduction package sufficient to put the budget on a path to meeting the fiscal goal. In this case, fiscal rules would enforce the promised deficit reduction by establishing barriers to actions rolling back deficit reduction and prompting further action if the deficit reduction anticipated in the package does not materialize.

This approach has some similarities to the policy in New Zealand, where the government is supposed to maintain debt at a "prudent level" and set specific targets for meeting that goal. If the debt deviates from these targets, the Minister of Finance must explain how the government intends to take to return to the "prudent levels."

Alternatively, fiscal rules can be established to provide for affirmative action by the President and Congress in the future to bring the budget into compliance with the fiscal goal.

A process for bringing the budget within the fiscal goal could require action on a single, comprehensive deficit reduction package that is gradually phased in over time or provide for a series of incremental deficit reduction packages over several years that achieve a certain amount of deficit reduction toward the ultimate goal. A single package would allow for greater tradeoffs and provide political appeal of solving the problem. However, it may be easier to build support for multiple packages over several years with more modest savings making progress toward the ultimate goal, with policymakers building on reforms that are successful and implementing new policies to achieve savings each year.

Enacting policy changes necessary to bring the budget on a path to meet a fiscal goal could be accomplished within the current structure of the budget process with certain reforms. The President's budget and Congressional budget resolution could be required to include sufficient deficit reduction to meet the fiscal goals. Importantly, the Congressional budget resolution should be required to include reconciliation instructions to enact policy changes necessary to achieve the deficit reduction called for in the budget resolution in order to meet the fiscal goal.

Stronger Budget Committees with the support of the leadership may be needed to make this happen. The Committee for a Responsible Federal Budget's *Better Budget Process Initiative* recently published a paper outlining several recommendations for strengthening the budget resolution, including making the Budget Committee a leadership committee with key stakeholders serving on the committee and converting the budget resolution into a joint resolution signed by the President with enforcement mechanisms.

Another approach would be to set up a special expedited deficit reduction process if the budget is not in compliance with the fiscal goal. The President could be required to submit legislation making policy changes which would be sufficient to bring the budget within the fiscal goal that Congress would be required to consider under an expedited procedure. Congress could put together an alternative deficit reduction package of its own, but if it fails to act within a specified period of time there would be an automatic vote on the package submitted by the President.

Alternately there could also be a provision allowing for an automatic vote on deficit reduction packages submitted by individual Members of Congress that achieve the required amount of deficit reduction and meet a certain threshold of support if corrective action has not been taken through the regular legislative process within a specified period of time.

A more drastic approach would be to outsource development of a fiscal plan to meet fiscal goals to a commission or fiscal stability board. Such an entity could provide a venue to make the tough choices and tradeoffs necessary to reduce the deficit that policymakers have been unable to make in the regular legislative process.

One model could be the National Commission on Fiscal Responsibility and Reform (Simpson-Bowles Commission), with a requirement for an automatic up-or-down vote on the recommendations of the Commission. An alternative model could be the Medicare Independent Payment Advisory Board which would recommend policies to meet the fiscal goal which would take effect unless Congress passes disapproval legislation rejecting them, though there may be Constitutional issues with that approach, particularly with revenues.

Once the fiscal goal has been met, there would still be a need for a process to enact further changes if the budget is projected to fall out of compliance with the fiscal rule within the budget window. Again, this could be provided through reforms of the existing budget process, a new expedited deficit reduction process or recommendations of an external body.

## A fiscal goal must be accompanied by enforcement mechanisms

Procedures to require action on policy changes to meet the fiscal goal need to be accompanied by a credible enforcement mechanism to give lawmakers the incentive to use the procedures to make the tough choices necessary to meet the goal. Specific mechanisms to keep a budget plan on track can be designed either as carrots or as sticks.

Regardless of the procedure established for legislative action to meet the fiscal goal, there should be a trigger enacting savings if lawmakers fail to enact legislation meeting the target. A trigger should be as broad-based as possible, applying to most if not all spending as well as revenues in order to give all policymakers an incentive to enact legislation to avoid the trigger and spread the burden of deficit reduction broadly. On the spending side, a trigger could make across-the-board cuts in spending programs, implement pre-determined policies to achieve savings or give an independent body authority to put forward policies to achieve savings. On the revenue side, a trigger could impose a temporary surtax or impose limitations on tax expenditures.

The trigger should at a minimum achieve the amount of savings required by the fiscal goal. It may be worth considering a trigger mechanism that achieves more savings than required to meet the target to give policymakers an incentive to enact thoughtful policy changes to meet the targets instead of allowing the more severe policies in the trigger take effect.

A fiscal goal could also be reinforced through the debt limit. Specifically, legislation establishing a fiscal rule with debt targets could provide for suspension of the debt limit for the upcoming fiscal year if the actual debt was at or below the target as a percentage of GDP in the prior year. This could be implemented through a version of the so-called "McConnell rule" allowing the President to suspend the debt limit subject to disapproval by Congress if debt targets were met. Alternatively, legislation creating a fiscal rule could provide for incremental increases in the debt limit in multiple steps over several years consistent with the debt levels allowed by the fiscal rule.

The potential to avoid a politically difficult vote on raising the debt limit would give the President and Congress an incentive to enact policies to meet fiscal goal and follow through with any actions necessary to keep the budget on course to meet the goal. But unlike the current approach in which debates about enacting policies to control the debt occur when debt is approaching the debt limit as a result of debt that has already been incurred, this approach would create an incentive to act on fiscally responsible policies before debt is incurred in order to meet the goal to avoid the need to pass an increase in the debt limit.

Adherence can be strengthened by having an independent monitor to keep track of the effects of policies and of the changing gap to the target, based in part on changing economic conditions as well as new policies. Both the IMF and the European Commission have recommended that countries establish an independent body to make these estimates in a transparent way.

In our system, CBO effectively plays this role. However, under the *Bowsher vs. Synar* ruling from 1986, measuring compliance with a fiscal rule for the purposes of implementing enforcement mechanisms must be done by an executive branch agency such as the Office of Management and Budget (OMB). Nonetheless, independent reports by CBO regarding compliance and a requirement that OMB explain any differences in estimates will provide for greater accountability and transparency in the process of enforcing a fiscal rule.

The Peterson-Pew Commission's 2010 report made a number of specific recommendations on the design of a fiscal rule that would employ debt targets, automatic triggers, and other means of enforcement to both force and help sustain agreement on policies needed to meet the targets.

The Commission's specific recommendations include:

- Establish medium-term and annual debt targets in statute, to stabilize the publicly held debt at a specified level by a specified year.
- Set annual targets to provide a glide path to achieve debt targets and use the projections in a reformed budget process to guide enactment of a multi-year budget to meet the enacted debt targets.
- Require Congress to pass, and the president to sign, a budget projected to meet each year's target.
- Require lawmakers to pass adjustments if re-estimates project missed targets.
- If all final legislation fails to meet the yearly target, use a trigger to automatically adjust spending and taxes to close at least part of the remaining gap.

## Conclusion

A fiscal rule is not a substitute for the tough choices to restrain spending or increase revenues in order to reduce the debt. However, a properly structured fiscal goal with procedures and enforcement mechanisms to ensure compliance with the goal can be a valuable tool to focus policymakers on the goal of reducing the deficit and providing for action to achieve the goal.

The pay-offs from establishing and complying with a fiscal rule are immense. I thank the committee for holding this hearing today and would be delighted to work with you on any of these issues.

Thank you.