

Honesty Is the Best Policy for Federal Budgets

By Diana Furchtgott-Roth



Diana Furchtgott-Roth

Diana Furchtgott-Roth, former chief economist at the Labor Department, is a senior fellow at the Manhattan Institute for Policy Research.

In this article, Furchtgott-Roth suggests ways to make the budget process more realistic and transparent.

With the deficit supercommittee facing a November 23 deadline for \$1.4 trillion in spending cuts, there is no better time to examine the federal budget process.

The deficit for fiscal 2011 reached \$1.3 trillion. The deficits for 2009, 2010, and 2011 have been the largest since the end of World War II, according to the Congressional Budget Office.

One approach is to raise additional tax revenue to bridge the gap. Earlier this month, President Obama proposed a 5 percent surtax on millionaires as part of the American Jobs Act of 2011. That bill was defeated in the Senate on October 11.

In September the president proposed raising the two top brackets to 2000 levels, which would have affected individuals making more than \$200,000 and joint filers making more than \$250,000 — despite making the case to the country in December 2010 that those tax rates should stay at current levels. Congress is not actively considering the proposal.

Another approach is to cut spending. The budget resolution passed by the House for fiscal 2012 would cut \$6 trillion from spending over the next decade and bring outlays to 2008 levels.

Budget reform would make it more difficult for Congress to spend taxpayer dollars. Currently, few limits exist on congressional spending, and Congress finds innumerable ways to get around its self-imposed rules.

Corporations may be evil, according to the Occupy Wall Street crowd, but at least they have to

stick to a budget. Their budgets must accord with generally accepted accounting principles. Shareholders, accounting firms, and the IRS carefully review different sets of books. No corporation would be able to get away with the budgets kept by Uncle Sam.

One example of a budget gimmick that recently made news is the Community Living Assistance Services and Supports program, or CLASS Act, a long-term care insurance program passed as part of the new healthcare law. Because payouts from the CLASS Act would have started five years after the program began collecting insurance premiums, the program showed a net gain of \$86 billion from 2010 to 2020. That lowered the cost of the new healthcare law within the 10-year window required for scoring revenue effects of legislation.

The program would have lost money in subsequent decades because the premiums collected would not have covered the expenses from long-term care for the beneficiaries. Department of Health and Human Services Secretary Kathleen Sebelius admitted on October 14 that HHS actuaries could not find a way to make the program fiscally solvent, so she was ending the program. The way the program was originally scored made it look like a revenue raiser, but in the long run it would have been a drain on the budget.

Sen. Jeff Sessions, R-Ala., ranking member of the Senate Budget Committee, said to me in a telephone conversation on October 14, "In a time of debt crisis, Congress first has to have a budget, then has to adhere to that budget. It's been almost 900 days since the Senate last passed a budget."

Sessions, in the Honest Budget Act, a bill cosponsored by Senate Finance Committee member Olympia J. Snowe, R-Maine, has proposed changes to the budget process to try to limit congressional budgeting gimmicks. Since 2005, Congress has spent more than \$350 billion using the maneuvers outlined in his bill, according to estimates by the CBO and the Office of Management and Budget.

The Honest Budget Act has eight major provisions.

1. Transfers from general revenues to trust funds should be scored. Perhaps most egregious, if not most costly, are the unscored shifts from general revenues to the Highway Trust Fund. The Highway Trust Fund is not raising the amount of revenue

needed to maintain the road system, so Congress has been steadily transferring additional funds.¹ However, those funds are not counted as spending. The act would require those transfers to count as spending, a change so obvious that it is hard to work out why it is not already law.

2. Emergency funding should be paid for. Most people are unaware that what Congress designates as emergency spending does not have to be paid for with tax increases or budget cuts. Further, emergency spending has a loose definition. In fiscal 2010 it added up to \$174 billion. In 2008 spending for the 2010 census was designated as emergency, even though the Constitution requires a census every decade.

The act would limit the way that emergency spending could be included in the budget. Rather than be included in a base bill, as is the case now, emergency spending could only be included as an amendment. That amendment could be stopped by a point of order by any member, requiring three-fifths of members to waive.

3. Count probability of default in loan guarantees. The Solyndra debacle, in which taxpayers were exposed to a \$528 million loss because of the bankruptcy of a solar power company that received federal loan guarantees, has shone sunlight on the loan guarantee process. Americans are very much aware that loan guarantees do not cover the riskiness of the loan or the probability of default. The risk of default tends to be higher with government loan guarantees than with private sector loans, because enterprises ask the government for funding they cannot raise privately.

The act would require the CBO to use realistic estimates of the cost of loans and loan guarantees, including the probability of default.

4. Deferring one expenditure should not lead to repeated savings. In a household budget, deferring the purchase of a \$500 refrigerator for a year would save \$500. Deferring it for a second year would still save the same \$500, and for a third year would also save — you guessed it — \$500. Total savings would equal \$500.

But the federal government operates by different rules. If \$500 million (our government does not deal in simple amounts of \$500) in mandatory spending were postponed to next year, the savings would indeed be \$500 million. But if it were postponed to a second year, the savings would equal \$1 billion. Postponing a third year would result in savings of

\$1.5 billion. The act would make it more difficult to count postponed savings more than once.

5. Prevent revenue raised from timing shifts. Readers of *Tax Notes* are all too familiar with revenue shifts being used to plug budget holes. Some tax legislation may require corporations to pay estimated returns early, to fulfill “pay as you go” considerations within a five- or 10-year window. Spending shifts can be used for the same purpose, such as the \$3.3 billion in supplemental security income payments that were moved from fiscal 2006 to fiscal 2007.

The act would prevent spending and revenue effects of timing gimmicks from fulfilling budget goals.

6. Tie appropriations to a budget. As we have seen, it is all too easy for the House or Senate not to pass a budget, even though passing a budget is one of Congress’s main responsibilities. A senator can raise a point of order to stop appropriations bills from being considered without a budget in place, but that point of order can be waived if 51 senators choose to do so. The bill would require three-fifths of senators to vote to waive the point of order, meaning that it would be easier for individual senators to insist on passage of a budget.

7. No rescissions of unspent funding. Under current rules, money that has been appropriated but not spent can be rescinded in another appropriations bill. However, even though some funds would have never been spent, they can still be used as savings to pay for spending in future years, raising the deficit. The act stops rescissions of budget authority that do not produce real savings.

Similarly, Congress has counted as savings cuts in future war spending over the next decade — even though fighting wars in Afghanistan and Iraq over the next decade is not even planned.

8. Stop automatic pay increases for federal workers. Even though Congress suspended cost of living raises for federal workers, and Obama declared a freeze on their salaries, federal workers still get automatic within-grade step increases. That means that a freeze is not a freeze — it is more like slush. The act would stop those automatic pay increases.

In addition to the Honest Budget Act, three other changes could put our country on the road to fiscal health. These changes are so honest, however, that they have practically no chance of passage in Congress.

1. Put the federal government on GAAP. Congress has exempted itself from GAAP and has adopted accounted conventions that apply only to the federal government. To most accountants, the federal budget is nonsensical. If the federal government had to file its accounts under GAAP, our current

¹In a prior article, I suggested devolving the Highway Trust Fund to the states. See “Time to Wind Down the Federal Highway Trust Fund?” *Tax Notes*, Feb. 7, 2011, p. 711, *Doc 2011-2256*, or *2011 TNT 25-8*.

measures of both the deficit and public debt would be much greater. Right now no obligations are counted beyond 10 years. They just do not exist. We count our deficit and debt on a cash basis, with no accrual accounting. Obligations decades out do not show up. That should change.

2. Vote on entitlements every budget. Congress should get rid of the concept of entitlements and put all expenses under the appropriations process. It is an abdication of responsibility to say that prior Congresses obligate the current Congress to spend money. Instead, Congress should pass a law that no money can be spent unless it gets specifically voted out each year. That could happen with a one-sentence law: "Notwithstanding any other provision of law, the United States shall expend no funds and shall be responsible for no liabilities and guarantees, except in amounts as specifically appropriated annually by Congress."

3. Link spending to receipts three years earlier. One way of ensuring that Congress always spent within its means would be to tie spending in a given year to revenues from three years before.²

²For more details, see Diana Furchtgott-Roth, "A Workable Balanced Budget Amendment," *Tax Notes*, July 25, 2011, p. 427, Doc 2011-15722, or 2011 TNT 142-14.

That would mean that the president and Congress would know in advance unequivocally how much money to spend. For fiscal 2012, for instance, they would know that they could not spend more than revenues from calendar year 2009, which ended December 31, 2009.

The three-year lag is appropriate because of the timing of tax receipts and budget planning. For instance, the known amount of tax receipts for calendar year 2010 is only available in the spring of 2011. Meanwhile, the president sent his budget for fiscal 2012 to Congress the first week of February 2011. His staff worked on that budget in the fall of 2010, when even third-quarter 2010 GDP was unknown. But if the fiscal 2012 budget were based on GDP in calendar year 2009, guidelines and limits would be clear to both the president and Congress.

The U.S. budget faces deficits as far as the eye can see. It is a sad commentary on our budget process that those deficits, with transparent budgeting, would actually be even larger than they now appear. Perhaps restoring some honesty to budget rules would rescue Congress from its record-low approval ratings and rehabilitate its reputation with the public.