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**BUDGET GIMMICKS OR THE DESTRUCTIVE ART OF CREATIVE
ACCOUNTING**

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Budget Gimmicks or the Destructive Art of Creative Accounting

Introduction

Economists argue that a key ingredient to fiscally responsible governmental policy is the setting of an explicit target for publicly held debt, such as the 60 percent of debt-to-GDP ratio and the 3 percent of GDP deficit targets set by the Treaty on European Union.¹ Similarly, it has been suggested recently that the way off the unsustainable fiscal path on which many countries have found themselves is to set such targets (such as a 60 percent of debt-to-GDP ratio by 2018), find enforceable mechanisms, and adopt policies (tax increases or spending cuts) that will achieve the target.²

However, there is more to fiscal responsibility than setting spending limits. For every attempt to cap spending by regulation or statute, lawmakers seem to find new and creative accounting techniques that allow them to continue spending recklessly. As economist Donald Marron notes, “[setting] a measurable target isn’t enough. You also need to make sure that the government doesn’t game the accounting to hide its liabilities.”³

In fact, there is evidence that creative bookkeeping is at the center of many countries’ financial troubles. Take Greece, for example. As a member of the European Union (and particularly as a member of the Eurozone), it is supposed to meet a 60-percent-of-debt-to-GDP target and 3 percent of GDP deficit target set by the European Growth and Stability Pact.⁴ However, according to the *New York Times*, with the help of Goldman Sachs, JP Morgan Chase, and a wide range of other banks, Greece managed to skirt the debt limits for years by using various accounting tricks.⁵

“In dozens of deals across the Continent,” the *Times* explains, “banks provided cash upfront in return for government payments in the future, with those liabilities then left off the books. Greece, for example, traded away the rights to airport fees and lottery proceeds in years to come.”⁶ The hidden liabilities misled investors and regulators about the extent of the country’s liabilities and enabled Greek lawmakers to mask additional borrowing.

In order to escape its financial constraints, Greece also excluded a large portion of its military spending from deficit calculations. An article in the February 22, 2010 edition of *The Wall Street Journal* called “Debt Deals Haunt Europe,” by Charles Forelle and Susanne Craig explains that “In 2000, Greece reported that it spent €28 million (US\$1.13 billion) on the military—about a fourth of the €1.17 billion it later said it spent. Greece admitted to underreporting military spending by €0.7 billion between 1997 and 2003.”⁷

Other examples include Portugal, which “classified subsidies to the Lisbon subway and other state enterprises as equity purchases” in 2001. France “arranged a deal with the soon-to-be privatized France Telecom in 1997 under which the company paid the government a lump sum of more than € billion. In return, France agreed to assume pension liabilities for France Telecom workers, which did not show up as a liability. The billions from France Telecom helped to narrow France’s budget gap.”⁸

Of course, these strategies or budget gimmicks are common in the United States as well. There are powerful incentives for using tricks to disguise the size of the budget deficit and to bypass formal budget process requirements. The outcome is that we end up with more spending, more deficits, and more debt.

Budget gimmicks, however, have consequences beyond letting lawmakers get away with spending money. With a limited budget, policy makers—like nearly everyone else in the world—must prioritize spending. They must choose the best policies to adopt based on available funds and forgo other projects. When legislators manipulate numbers in order to fund programs that might not otherwise pass muster, they are not obligated to show that the programs serve genuine social or financial policy objectives.

This paper enumerates some basic budget gimmicks that U.S. government officials use to hide the size of deficits, debts, program costs, and revenue losses. (The list of gimmicks is by no mean exhaustive.) Some of these strategies include pretending the spending does not exist, pretending the spending is smaller than it is, pretending that spending is really an investment, pretending the tax revenues will be bigger than should reasonably be expected, and/or pretending that future pension liabilities do not exist. Given the many spending limits in place that elected officials nonetheless manage to avoid, this paper concludes that few methods will successfully cap spending short of shrinking the size of government, a long-term approach to say the least. In the near term, serious, strict, and unavoidable budget rules need to put in place to tie Congress’ hands and restore fiscal discipline.

Section 1. Budget Rules in the United States

Responding to voters’ demands for fiscal discipline, most lawmakers (including then-Senator Barack Obama on the campaign trail) claim to be budget hawks. Hence, politicians frequently express their concern about the size of the deficit or support for various rules meant to slow down Congress’ spending.

The Congressional Budget and Impoundment Control Act of 1974 was the first law to establish a comprehensive process for considering budgetary matters, including mandating the use of a budget resolution. The budget resolution sets out requirements for the fiscal year beginning on the following October 1 and for at least four subsequent fiscal years. These requirements include levels of total new budget authority and outlays; total federal revenues, including the amount, if any, by which the level of federal revenues should be increased or decreased by legislative action; the surplus or deficit in the budget; new budget authority and outlays for each major functional category; and the public debt.⁹

The act requires that once the budget resolution sets aggregate spending levels, the appropriations committee in each chamber is given an allocation for spending called a 302(a) allocation.¹⁰ After the appropriations committees receive the aggregate allocation, they divide it into sub-allocations called Section 302(b) sub-allocations, which correspond to each of the thirteen appropriations subcommittees. The two chambers do not need to have the same 302(b) allocations for each subcommittee, but the grand total must meet the agreed-upon 302(a) allocation set by the budget resolution.¹¹

The purpose of the 302(a) allocation is to serve as an internal Congressional control mechanism, enforceable through points of order and other procedural mechanisms in both the House and Senate. In theory, the appropriations committees in the House and Senate cannot exceed the aggregate total in the bills they develop in the annual appropriations process.

In reality, however, these rules are often ignored. The general public sends the signal that it favors spending cuts. New data even show that spending cuts can actually be a *good* thing politically.¹² Yet, any proposals for specific cuts are met with vocal opposition and lobbying against spending cuts by the interest groups that support these programs. As James L. Payne explains, “The avalanche of one-sided propaganda in favor of federal programs creates a false picture for policymakers. They live in Neverland where federal spending programs are routinely portrayed as necessary, helpful, and effective.”¹³ The result is that Congress continues to fund, year after year, programs that are actually wasteful and should be abolished.

But to spend more, lawmakers have to go around the budget rules. That is what budget gimmicks accomplish. Advocates of new spending programs seek cost projections that are low enough for the programs to fit under the budget caps. Similarly, tax-cut proponents look for projections that minimize revenue loss so they can keep spending at current levels without it appearing that they are growing the deficit.

Identically, when nervous voters focus on the size of the deficit and the enormity of the debt that we will pass on to future generations, the party in power has an incentive to keep deficit projections low by ignoring some government liabilities. Despite the fact that the other side has an interest in painting a much darker—and often more realistic—picture by highlighting these hidden liabilities, in the end we are left with more spending and more debt.

This tension between budget rules and budget gimmicks isn’t new of course. Recall the Balanced Budget and Emergency Deficit Control Act of 1985, commonly referred to as the Gramm-Rudman-Hollings Act after the authors of the original bill. The act was meant as a fiscal responsibility tool and set maximum amounts for the federal deficit. The idea was that each year, deficit targets would decrease until the budget was balanced in FY 1991. If the deficit limits were exceeded, the president was required to cut spending by a uniform percentage across the board to bring the budget back into balance, a process called “sequestration.”

Depending on the year and the administration, some parts of the budget were exempted from such cuts. In fact, by 1990, it became very clear that Congress had put into place so many loopholes and exempted so much spending from sequestration that the entire Gramm-Rudman-Hollings framework was falling apart. By then, the budget exceeded the deficit limit by nearly \$100 billion, and the deficit targets would have required that the few programs still on the chopping block be cut by about one-third.

In response, Congress passed the Budgetary Enforcement Act (BEA) of 1990, which specified two new deficit reduction mechanisms: pay-as-you-go (PAYGO) rules and statutory discretionary spending caps. PAYGO required across-the-board cuts to non-exempt, mandatory spending if the sum of proposed new spending and revenue measures would increase the deficit. Again, after much debate, large categories of spending were exempt from PAYGO, including Social Security. Furthermore, cuts in Medicare spending were limited to 4 percent, making the measure irrelevant. In 2002, lawmakers finally let the rule expire altogether.

Now, after a seven-year hiatus, the statutory PAYGO is once again the law of the land.¹⁴ However, it is so watered down that it is unlikely to exert much fiscal constraint. First, it only applies to *new or expanded* entitlement programs that may increase the deficit. It does not apply to existing programs, such as Medicare, Medicaid, and Social Security. Nor does it apply to discretionary spending, which represents roughly 40 percent of the budget.¹⁵

As we will see, many gimmicks are about getting even more spending exempted from the PAYGO rule. And it seems to be easy. As Paul Ryan (R-WI), the ranking Republican member of the House Budget Committee, has noted since 2007 the Democrats under Speaker Nancy Pelosi (D-CA) “have violated pay-as-you-go rules by nearly \$1 trillion.”

Section 2. The Emergency Loophole

One of the oldest and most basic gimmicks in the playbook is to fund government activities thought emergency spending.¹⁶ Originally intended as a way to address pressing and unforeseen spending needs, the supplemental process is now regularly contravened by “emergency” spending where no emergency exists.¹⁷

Here is how it works. Part of the budgetary process since the first U.S. Congress,¹⁸ supplemental appropriations are supposed to fund programs that cannot wait until the next appropriations cycle or that have very recently enacted authorizations. Originally, the president and Congress used supplemental bills to cover *unexpected* costs due to natural disasters or war.

Furthermore, supplemental bills given an “emergency” designation avoid certain budgetary rules, making them even easier to approve. For instance, emergency bills do not count against House and Senate budget caps; Congress and the president can use

them to increase the level of discretionary spending without having to cut spending elsewhere in the budget.

And they have done just that. Each year over the last two-and-a-half decades, Congress and the president have enacted between one and eight supplemental spending bills, ranging from \$1.3 billion in FY 1988 to \$120 billion in FY 2007.¹⁹ Supplemental spending as a share of total new budget authority has increased over this period as well, ranging from 0.1 percent in FY 1988 to 6.2 percent in FY 2005.²⁰

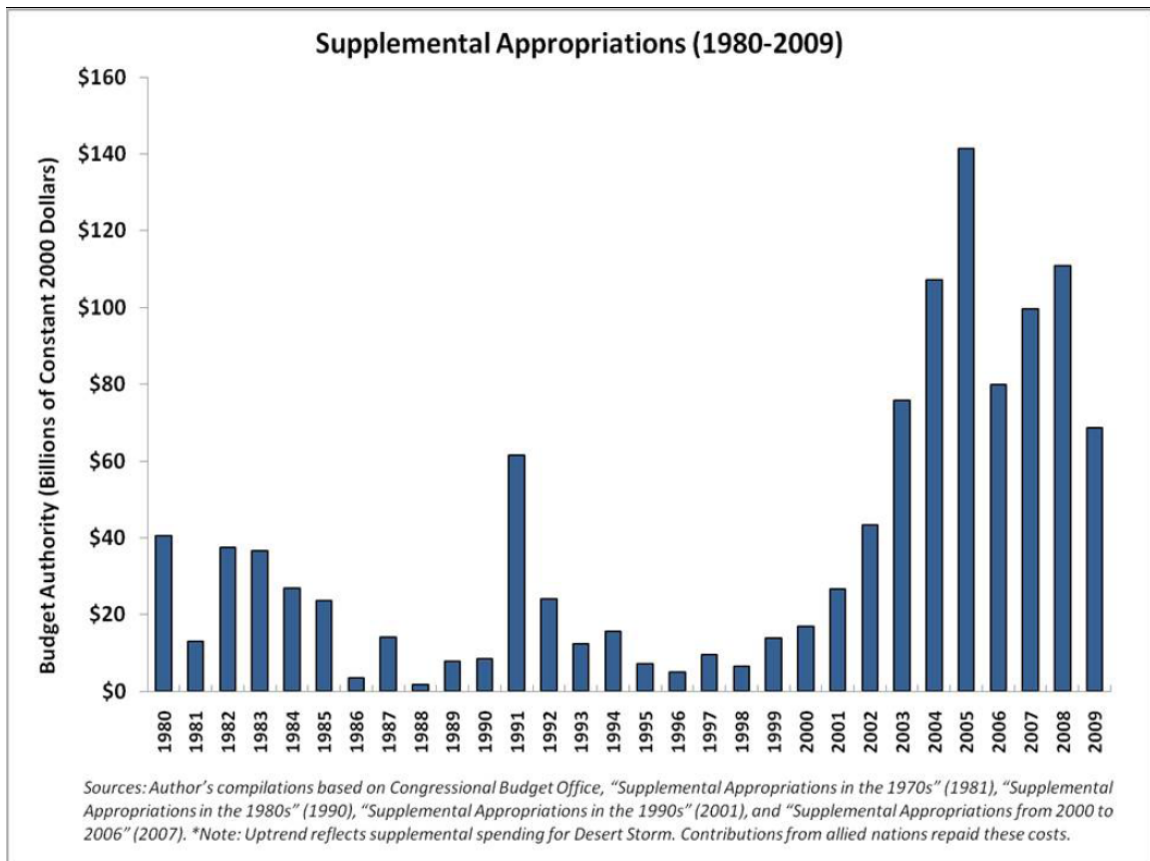


Figure 1: Trend in Supplemental Spending Since 1980 in Constant Dollars

Not surprisingly, emergency spending has constituted nearly all of each year's supplemental spending over the last decade (with the notable exception of FY 2003),²¹ making supplemental bills the primary vehicle for growth in emergency spending and making supplemental appropriations an effective way to spend more than the limits originally set by Congress.²²

Compared to regular presidential budget requests, supplemental budget requests include little detail about how the money will be spent. This flexibility is necessary for responding to unforeseen needs, but too much flexibility effectively gives executive branch agencies a blank check. Supplemental bills also tend to move through Congress more quickly, again because they are intended to address pressing and unforeseen needs.

Finally, the political effect of the word “emergency” increases public pressure for quick passage, largely muting opposition.

The total effect of spending occurring in a supplemental bill *and* designated as an “emergency” appropriation is that oversight, scrutiny, and debate are significantly curtailed and unnecessary spending often breezes through. As a result, supplemental appropriations often contain pet projects that would not be approved with normal levels of Congressional oversight.

From war funding to natural-disaster relief, these supplemental appropriation bills often leave Congress laden with large amounts of additional funding for unrelated purposes. For instance, the War Supplemental Appropriations Act (2003) appropriated \$348 million for 29 projects unrelated to the war, such as \$110 million for the National Animal Disease Center in Ames, Iowa. The Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Tsunami Relief (2005) contained \$1.13 billion for projects that had nothing to do with defense or tsunami relief, including \$55 million for wastewater treatment in De Soto County, Mississippi and \$25 million for the Fort Peck Fish Hatchery in Montana.²³

More problematic is the fact that emergency spending takes place outside of the budget caps and frees up funds within the budget process for additional spending. For example, by substituting supplemental for regular defense spending, Congress frees up those amounts for both more defense and non-defense appropriations. Brian Riedl, a budget analyst at the Heritage Foundation, explains, “The common usage of defense supplemental bills has increased non-defense spending as well. Lawmakers now try to shift budget resolution funds from defense to domestic programs, knowing that these defense funds can be replenished by adding to the next supplemental bill.”²⁴

For instance, in early May 2006, House Appropriations Chairman Jerry Lewis (R-CA) asked that \$6 billion from proposed defense increases be shifted to boost domestic programs.²⁵ The money was used in part to erase almost \$4 billion in cuts proposed for programs funded in the FY 2007 Labor, Health, and Human Services measure, which brought funding back to its FY 2006 level.²⁶ Examples like this one are abundant.

This trend is even more acute since the expiration in 2002 of the last few Budget Enforcement Act rules. In the 1990s, for instance, lawmakers had to use rescissions—reductions or cancellations of budget authority elsewhere in the budget—to offset at least a portion of the increase in supplemental appropriations.²⁷ They don’t anymore. As the Congressional Research Service notes, “had supplemental appropriations been fully offset since 1981, federal debt held by the public could have been reduced by 18 percent or \$830 billion.”²⁸

But these practices do more than just add spending to an already bloated budget. Take the defense budget for example. Thomas Donnelly argues that “[r]elying so heavily on supplemental funding distorts the Defense Department’s priorities and perverts proper planning.”²⁹

Unfortunately, it seems that administrations can't escape the attraction of the emergency loophole. Last year, President Obama vowed to change the Bush administration's practice of funding the \$700 billion price tag for the Iraq and Afghanistan wars through emergency supplemental bills.³⁰ "I am committed," Obama said during his February 2009 address to a joint session of Congress, "to restoring a sense of honesty and accountability to our budget. That is why this budget looks ahead 10 years and accounts for spending that was left out under the old rules—and for the first time, that includes the full cost of fighting in Iraq and Afghanistan. For seven years, we have been a nation at war. No longer will we hide its price."³¹

Nonetheless, in May 2010, the president resumed the use of emergency funds for non-emergency items such as the ongoing Afghanistan and Iraq wars and summer jobs programs. The president also requested emergency funding for the Haiti earthquake relief and for clean-up of storms and the gulf oil spill through the supplemental process. If one believes these are legitimate functions of the government, this is a correct use of the emergency label. However, the lack of spending cuts elsewhere in the budget means that this money, \$58.8 billion after going through the Senate, will be added to the taxpayers' tab.³²

Section 3: Keeping Off the Record

Another classic gimmick is keeping spending off the official budget (as Greece did with its defense spending). Technically speaking, the term "off-budget" only refers to entities explicitly excluded from the budget by statute. According to the United States Senate glossary, "At present, off-budget entities include the Social Security trust funds and the Postal Service."³³

The distinction between what is called "on-budget" and "off-budget" is meaningless. Social Security is spending like any other spending. But lawmakers keep other spending items off the record *informally*. For instance, the government-run mortgage lenders Freddie Mac and Fannie Mae are on track to cost taxpayers \$64 billion between 2011 and 2020, on top of the \$110 billion in taxpayer money they have already spent.³⁴ While this cash infusion is included in the budget, the subsidy cost of new loans or loan guarantees made by Fannie and Freddie, which have a total projected cost of \$370 billion through 2020, is not included. As Tad DeHaven explains, the move has two purposes: First, "the administration doesn't want the [government sponsored enterprises (GSEs)] "on budget" because it will only make already dismal deficits look worse. It also hinders any effort to count the GSEs' combined \$1.5 trillion in outstanding debt against the ever-increasing federal debt limit."³⁵

Similarly, the federal government has been extending implicit or explicit guarantees to the debts of many financial institutions beyond Freddie and Fannie. These guarantees have a cost not recorded in the budget.³⁶

Beyond just guarantees, starting in 2008, the federal government bailed out several firms in distress, in addition to Fannie Mae and Freddie Mac, mainly through the \$700 billion

Troubled Asset Relief Program (TARP). It then extended the bailout to the automotive sector. In most cases, the bailout took the form of a government takeover of equity investments in firms that received government funding and backing. Although the equity the government owns has value, these companies also have large debts for which U.S. taxpayers are now partially responsible.

One of the biggest recipients of the bailout was AIG, one of the larger insurance companies in the United States at the time. As explained by George Mason University Law Professor J.W. Verret, “AIG’s bailout was directed by the Federal Reserve, a public institution backed by the Treasury Department but one step removed from the U.S. government. The second largest recipient was Citigroup, the largest bank in the United States. The Treasury Department uniquely took a common voting equity interest of 34 percent in exchange for the funds it injected into Citigroup.”³⁷ And yet, the new obligations that accompany the federal government’s ownership of private firms through the TARP bailout are not accounted for in the net position of the United States. They are effectively off the record.

Another way for the government to spend money while leaving it *informally* off budget is to commit to the spending without funding it. Federal employee retirement funds are such an unfunded obligation.³⁸ The financial commitment—\$5,284 billion—appears in the Department of Treasury’s Financial Statement of the United States on page 3 in a table called “The Federal Government’s Financial Position and Condition,”³⁹ as well as in the “Federal Funds section” of the budget,⁴⁰ but it is not included in the deficit calculation.

More concerning is the fact that the off-budget game doesn’t just hide financial commitments or spending. It also allows lawmakers to take advantage of the fact that most government trust accounts (e.g., Social Security) bring in more than they spend in the short term, even though they have substantial unfunded liabilities in the long run. For instance, for years Congress and the president have routinely raided the short-term surpluses in these funds to pay for current spending on other programs,⁴¹ thereby making the budget deficit and debt seem smaller while spending more money today. This gimmick is covered extensively in Section 7 of this paper.

Section 4: Timing Gimmicks

Timing gimmicks rest on the manipulation of the budget year in which particular items of revenue or expenditure are reported. Some of them involve simply accelerating receipts or delaying payments into alternate budget years or taking advantage of the fact that the federal budget operates under a fiscal year that begins on October 1 while many government activities are based on the calendar year or some other time period.

For instance, large payments to contractors or vendors due by the end of one fiscal year (September 30) are often paid on October 1, which occurs in the next fiscal year. That lets Congress “save” money in the current year though at the cost of having to double up on expenses the year after. The shift of \$5.2 billion in outlays from 2006 to 2007 by temporarily halting payments to Medicare providers for the last six business days of FY

2006 is a good example of this gimmick.⁴² Both the estimated tax and the Medicare payment provisions adopted by Congress in 2005 had no real substance. They were enacted for no reason other than to satisfy numerical budget reconciliation limitations on spending for each of the individual fiscal years and the aggregate budget window covered by the reconciliation instructions.

Another common timing gimmick is the use of advance appropriations. According to the FY2011 Budget of the United States' appendix, "An advance appropriation is one made to become available one year or more beyond the year for which the appropriations act is passed. Advance appropriations in 2011 appropriations acts will become available for programs in 2012 or beyond. Since these appropriations are not available until after 2011, the amounts will not be included in the 2011 totals, but will be reflected in the totals for the year for which they are requested."⁴³

The purpose of not acknowledging the spending commitment in the year it is made in is a clever way to free up money under the budget caps, allowing Congress to spend more money in that year. However, the invoice inevitably arrives and Congress needs to rely on more advance appropriations to keep its spending going.

For the last 20 years, there have been about \$20 billion of discretionary advance appropriations per year. In FY2009, discretionary advance appropriations totaled \$26 billion. By FY 2012, they will reach \$79.8 billion. This is an astonishing increase in the use of advance appropriations mainly due to an increase in the Department of Veteran Affairs' Medical Services.⁴⁴ Total advance appropriations, which include both discretionary and mandatory ones, will reach \$183 billion in FY2012 and will pay for everything from tenant-based rental assistance to programs such as "Children and Families Services" to "Grants to States for Medicaid."⁴⁵

Another common timing gimmick involves the manipulation of the "budget window." Understandably, to be of any value budget information must be presented using a defined time frame. Until the end of the '80s, presentation of budget information was done on a short, one-year basis. As a response, the 1990 Budget Enforcement Act moved to a statutory five-year minimum budget window.⁴⁶ But that changed again in 1997, when Congress started requesting ten-year budget information from the Congressional Budget Office (CBO), as did the Office of Management and Budget (OMB). Beginning with the president's proposed budget for FY 2004, however, OMB shortened its forecasting window from ten years back to five.⁴⁷ In 2010, OMB reverted back to a ten-year budget window.⁴⁸

These many changes in the budget windows are an expression of a real tension. As Cheryl Block explains, "On the one hand, short-term budgets, deliberately or inadvertently, may provide information that inaccurately reflects or distorts the long-term perspective so important to informed policy decisions. On the other hand, the necessarily more speculative nature of long-term projections can result in budget numbers that turn out to have been inaccurate with the benefit of hindsight."⁴⁹

This valid concern, however, does not alter the fact that changing the budget window from one year to the next or using budget windows inconsistently within the same budget year is often used as a way to manipulate budget numbers. For instance, the change in 2004 from ten years to five years was probably an attempt by President Bush to project smaller revenue loss from his 2001 and 2003 tax cuts.⁵⁰

But there are many more ways to take advantage of the budget window. When early drafts of the health-care reform bill rang up at around \$1.6 trillion, it was clear that it would almost certainly be impossible to pass a bill with that kind of price tag.⁵¹ As a result, President Obama directed Congress to limit the cost of the bill to \$900 billion over a ten-year period. One of the ways to lower that figure was by starting the revenue mechanisms immediately but holding off on implementing the benefits. As a result, both the Senate bill (\$848 billion) and the House bill (\$1.05 trillion) were structured so that their ten-year “scores” from the CBO would be based on a full ten years of revenue but less than ten years of spending (six years in the Senate bill, and seven in the House bill).

Clearly back loading spending doesn’t only hide deficit spending; it also hides the full cost of a piece of legislation. (The full ten years of the bill’s programs actually comes to more like \$1.8 trillion—not counting additional costs imposed by the individual mandate.)⁵² In fact, since the adoption of the new health care law, a new study by Richard S. Foster, the chief Medicare actuary, found that the reform will not slow the overall growth of health spending because unaccounted-for costs—specifically the expansion of insurance and services to 34 million people—will offset cost reductions in Medicare and other programs.⁵³

Whether lawmakers would have adopted the health-care reform bill if they had had full visibility of the reform cost is an open question. However, we can safely assume that taxpayers are likely to be better served if policymakers have more rather than less accurate financial information before they adopt a given policy.

Section 5: Cherry Picking Numbers

To assess the financial impact of legislation and legislation reform, lawmakers rely on two key pieces of economic information. The first one is the base that is used for purposes of comparison, called the budget baseline. According to the Senate glossary, “The baseline is the projection of the receipts, outlays, and other budget amounts that would ensue in the future without any change in existing policy. Baseline projections are used to gauge the extent to which proposed legislation, if enacted into law, would alter current spending and revenue levels.”⁵⁴

The second piece of information is an estimation of revenue that would be generated, or cost that would be incurred, as a result of proposed legislation, referred to as the legislative proposal’s “score.” Playing with the numbers that inform the baseline and the scores is a way to get more spending.

The existence of numbers from different official groups within government—OMB, CBO, or the Joint Committee on Taxation (JCT)—offers many opportunities for number shopping. Each scoring entity uses different rules and methodologies. For instance, the CBO scores our financial position exclusively using legislation already enacted, without taking into consideration policy changes that may occur in the future, no matter how likely. OMB, on the other hand, will score our deficit position using projections of policy changes envisioned by the administration, whether or not these changes are likely to occur.

In addition, legitimate disagreements exist over how to score expiring tax cuts or the stimulus impact on the economy.⁵⁵ As a result, a given legislative proposal can get different scores or start from different baselines depending on which office is doing the scoring.

For instance, the following chart illustrates the difference between the CBO estimate of the deficits in the next ten years and the OMB ones. This difference provides lawmakers with an opportunity to pick and choose based on the message they want to send to their colleagues on the floor of Congress or to their constituents back home.

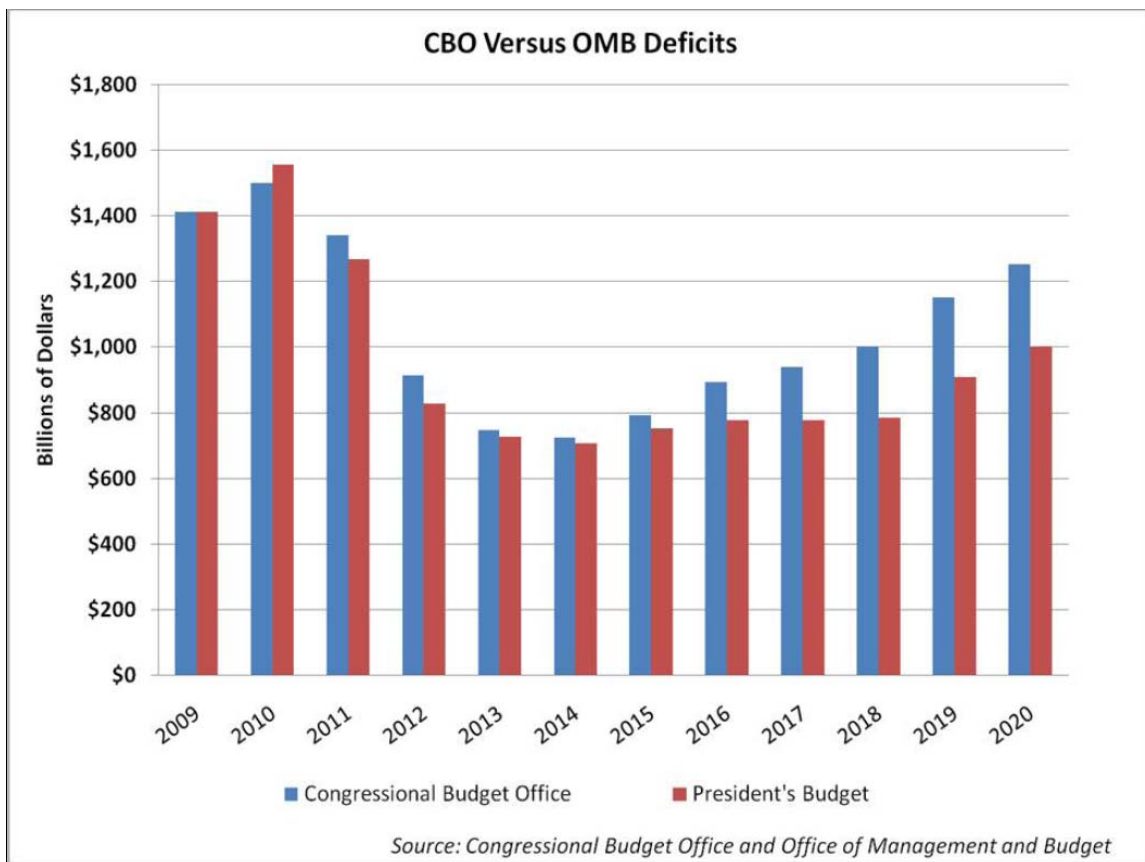


Figure 2: CBO versus OMB Deficits

Inevitably, lawmakers from both political parties take advantage of the different available cost and revenue estimates, particularly as the economic and political stakes of legislation increase.

Occasionally, however, cherry picking numbers is not about hiding the cost of government. Sometimes lawmakers shop for numbers to overstate a program’s fiscal burden to boost the case for government intervention.

Take the Obama administration’s projections about long-term health care costs. Unlike any administration before, it rejected the Medicare trustees’ projections in favor of its own number, which happens to be twice as big. As economist Andrew Biggs of the American Enterprise Institute explained in the February 2010 issue of *The American*, “The effects of this change are staggering: the administration’s 2010 budget, which followed the trustees’ assumptions, projected Medicare costs of 9.6 percent of GDP by 2080. The 2011 budget, which uses White House assumptions, projects Medicare will consume 22 percent of GDP by 2085.”⁵⁶ The lower estimate undercuts the administration’s contention that increased federal control of health care is necessary to reduce Medicare and Medicaid costs.

The direct result of this gimmick is to promote the government takeover of health care provision, which ultimately increases our spending and debt levels, but more importantly it cannot be appropriately evaluated as a policy solution to health-care’s problems without an accurate understanding of its cost.

Section 6: Rosy Scenarios

While some gimmicks are detectable only by budget experts, an easy one to spot is the rosy projection trick. Every administration does it. Perhaps the best known example is the rosy scenario projected by the Reagan Administration. As David Stockman, then-director of OMB and the person credited with coining the expression “rosy scenario,” explains in his book *The Triumph of Politics*, much of the accumulated \$2 trillion in deficits between 1982 and 1986 were the product of rosy scenarios about the economy. This table illustrates his point.

Rosy Scenario and Nominal GNP: The \$2 Trillion Error (Money GNP in US\$ Billions)

Year	Rosy Scenario	Actual Economy	Error
1982	3,192	3,054	138
1983	3,598	3,229	369
1984	4,000	3,581	419
1985	4,398	3,839	556
1986	4,812	4,152	660
Total 1982–86	20,000	17,855	2,145

Thirty years later, little has changed. As the table below shows, in spite of being in the middle of a recession, President Obama’s first (2009) budget included very optimistic FY2010 GDP forecast.

Table 1: Optimistic GDP Projections from President Obama’s First Budget (Change in Annual Real Gross Domestic Product)

Forecast From	FY2009	FY2010
White House FY2010 Budget	-1.20%	3.20%
Congressional Budget Office January 2009	-2.2	1.5
Average Private Forecast	-2%	2.00%
Stress Test Worse Case	-3.30%	0.50%

Sources: OMB, *A New Era of Responsibility* (Washington, DC: GPO, 2009), summary tables, table S-8, and Peter S. Goodman, “Sharper Downturn Clouds Obama Spending Plans,” *New York Times*, February 27, 2009.

As a result, the unemployment rate at the end of President Obama’s term in 2013 was projected to be 5.2 percent, according to the White House, even though the rate at the time was 7.6 percent, and many economists expect it to climb past 9 percent before the recession ends. Meanwhile, the White House assumed a much slower rate of consumer price inflation than private-sector economists between 2010 and 2013.

Obama’s second budget (done in 2009 for 2010) also relied on revenue and outlay estimates that were very optimistic. The budget assumed real gross domestic product growth of 4.3 percent in FY 2011, followed by another 4.3 percent increase in FY 2012, while the CBO projected a little more than half that growth (2.3 percent) during those two years.⁵⁷

As a result, Obama also penciled in an 18.5 percent increase in revenue between FY 2010 and FY2011. That increase allowed him to project that the deficit will shrink from \$1.6 trillion this year to \$1.2 trillion next year.

The obvious benefit of these rosy projections—a recurring element in every administration’s budget projections—is that billions of dollars in phantom revenues can alter the size of the deficit or mask a new increase in spending. They also allow for phantom welfare spending cuts. If the economy were in fact going to grow that fast, one could assume that fewer people would be unemployed and collecting unemployment benefits and food stamps. This allows more room for other spending and makes deficit projections look better. When the unfortunate reality ultimately kicks in, it is too late because spending decisions have already been made and programs have been implemented. As a result, deficits increase and debt accumulates.

Section 7: Accounting Gimmicks

All the previous gimmicks very likely resulted in more spending. How much money they cost is hard to tell. However, whatever the amount is, it pales in comparison to the accounting fiction that governmental trust funds represent. The cost of this gimmick could be as high as \$4.4 trillion in new taxes or new borrowing by the federal government (more than the federal government spends in a year).

Take the Social Security Trust Fund for instance. In the early 1980s, the financial projections of the Social Security Administration indicated that near-term revenue from payroll taxes would not be sufficient to fully fund near-term benefits (thus raising the possibility of benefit cuts). The federal government appointed the National Commission on Social Security Reform, headed by Alan Greenspan, to investigate what changes to federal law were necessary to guarantee the fiscal health of the Social Security program.

As a result of the commission's recommendation, changes to federal law were enacted in 1983 to increase the Social Security payroll tax so that revenues derived from the tax would exceed the amounts needed to fully fund current benefits, thus causing a reserve to accumulate, which could be drawn upon when necessary.⁵⁸ The resulting surplus is accounted for in the Social Security Trust Fund.

As the story goes, Social Security has been accumulating a \$2.5 trillion trust fund from taxes that business and individuals pay on their earnings. This money, most people believe, is saved somewhere producing interest and it will be paid back to them when they retire. Also, the story continues, when Social Security starts registering a cash deficit (paying out more than it receives in taxes), the shortfall will be made up by withdrawals from the trust fund's assets. So even in case of a cash flow deficit—the difference between tax receipts and benefit payments—the trust fund will continue to show net growth until 2025 because of the interest generated by its bonds, until it is completely depleted by 2037.⁵⁹

In reality, the trust fund and the interest payments it receives are an accounting fiction. The surplus payroll taxes that taxpayers have been paying for years to build the trust fund have, in fact, been used and spent by the federal government on other things, such as wars, education, and homeland security. In other words, the federal government has been using the money to pay for its daily consumption rather than investing it for future expenses. In other words, the money is gone.

The sum of money that the federal government has borrowed from the Social Security Trust Fund appears as intragovernmental debt holdings, along with the money borrowed from all the other trust funds (such as Medicare's).⁶⁰ As of 2009, this debt reached \$4.391 trillion, including \$2.296 trillion borrowed from the Social Security Trust Fund, \$372 billion borrowed from the Medicare Trust Funds, and others.⁶¹

Some economists and many in the public may believe that these IOUs represent an asset.⁶² The reality is different. Unlike a typical private pension plan, the Social Security Trust Fund does not hold any marketable assets to secure workers' paid-in contributions. Instead, it holds non-negotiable Treasury bonds and securities backed by the full faith and credit of the U.S. government.⁶³ Even the interest paid to the trust is in the form of IOUs.

In 2000, OMB described the significant distinction between a typical private pension plan and Social Security as follows: “These [trust fund] balances are available to finance future benefit payments and other trust fund expenditures—but only in a bookkeeping sense. . . . They do not consist of real economic assets that can be drawn down in the future to fund benefits. Instead, they are claims on the Treasury that, when redeemed, will have to be financed by raising taxes, borrowing from the public, or reducing benefits or other expenditures. The existence of large trust fund balances, therefore, does not, by itself, have any impact on the government’s ability to pay benefits.”⁶⁴

That means that the trust fund can’t get cash for its assets unless the federal government borrows the money from the public—increasing the amount of debt held by the public—or increases taxes. The Financial Statement of the United States explains that point: “When those securities are redeemed, e.g., to pay future Social Security benefits—the government will need to obtain the resources necessary to reimburse the trust funds.”⁶⁵

Obviously, whether or not the IOUs in the various trust funds have a financial and/or committal value is a different question, which was asked of Alan Greenspan, then the Federal Reserve chairman, during a 2001 Senate hearing. Questioned about whether the trust fund investments are “real” or merely an accounting device, he responded, “The crucial question: Are they ultimate claims on real resources? And the answer is yes.”⁶⁶ In other words, the IOUs are a claim, not an actually asset.

At the blog *EconLog*, economist David Henderson gives a concrete example of the trust fund accounting fiction. He writes:

“Let’s make it more concrete with a personal situation that many people can relate to. Say you’re planning to send your kid to college. You have ten years and think you need \$100,000. In Scenario A, each year you put an IOU for \$10,000 in a jar. At the end of ten years, you pour out the jar, swear a bit more than is proper, and then scramble to come up with \$100,000, either through borrowing, selling assets, earning more, or spending less. In Scenario B, you skip the jar and IOU charade and advance to the final step: you swear and scramble. The IOU charade was irrelevant.”⁶⁷

These deceptive accounting techniques have resulted over the years in a deficit of \$4.4 trillion that is in effect unaccounted for, and that’s on top the \$45.8 trillion of the Social Security net expenditures—read Social Security and Medicare (Parts A, B, and D) unfunded liabilities—that the federal government has accumulated over the years.⁶⁸ The biggest losers are the millions of taxpayers who have overpaid their payroll taxes over the years in exchange for a promise of benefits that they will either not receive or that they will have to pay all over again before they get anything. This deception makes a remarkably strong case for the privatization of the accounts and makes this one the biggest gimmick of all.

Conclusion

Lawmakers' appetites for spending have turned the budget process into a mockery of what ought to be a transparent and somber determination of how best to spend taxpayers' resources. If the budget rule is that the deficit cannot be more than a certain percentage of GDP, then Congress will ensure to exclude as much spending from the deficit calculation as is needed to remain below that level. If the rule is that spending should remain below some pre-decided budget caps, lawmakers will find ways to label the spending so it doesn't count against these caps. What legislators will not do is restrict spending.

Lower levels of government are also sucked into the process. Since most state and local governments are required to balance their budgets, they have turned hidden borrowing into an art form. For instance, borrowing from state employee pension plans, underfunding them (which amounts to the same thing), and selling future tobacco tax settlement revenues at a steep discount are some of the more popular schemes.

In other words, when there are rules, there are attempts to go around them by finding a loophole. Lawmakers who understand and can manipulate the rules have enormous power. As House Minority Leader Robert H. Michel (R-IL) said once, "Procedure hasn't simply become more important than substance—it has, through a strange alchemy, become the substance of our deliberations. Who rules House procedures rules the House—and to a great degree, rules the kind and scope of political debate in this country."

This quote is very relevant to budget accounting, and procedural rules are at the center of most policy decisions made. Few people fully understand these rules. The ones who do can, it seems, get around them and get what they want with little opposition. They, ultimately, dictate the policies implemented in the country.

In this context, it is unrealistic to even imagine that the opportunity to use budget gimmicks and the temptation to spend more can ever go away. In fact, one response to this widespread spending is to pass stricter budget rules. But while such rules may be preferable, legislators will always find loopholes. Implementation of the PAYGO rules is a good example of that.⁶⁹

The long-term solution to this problem is reducing the size and scope of the federal government—not instituting spending caps that legislators easily overturn or skirt. If the government's scope is dramatically limited, so will be its ability to spend recklessly.

A first step would be for policy makers to identify programs for abolition. Cutting the cord between states and the federal government would also go a long way to shrink the size of federal spending. For instance, federal policy makers should eliminate all 800 federal grants to the states and eliminate the federal income tax deductible of lower government taxes (for both businesses and individuals). This would go a long way toward achieving fiscal responsibility.

In the near term, Congress should consider a complete overhaul of the budget process. Today, there are effectively no rules that credibly limit spending at the federal level. One

potential solution is to adopt a law that firmly limits annual increases in federal spending. Cato Institute's Chris Edwards explains that a good example of such a rule was recently introduced by Texas Representative Lamar Smith.⁷⁰

He writes, "The solution is for Congress to pass a law limiting annual increases in overall federal spending. Rep. Lamar Smith (R-TX) recently introduced legislation to do just that. His SAFE Act (H.R. 5323) would cap annual growth in the federal budget to inflation plus population growth. Smith's bill, which has 34 co-sponsors, would cap growth in all spending including defense, nondefense, and entitlements. If spending this year was \$3.70 trillion, inflation was 2 percent, and population growth was 1 percent, then federal spending next year would be limited to \$3.81 trillion. If Congress failed to get spending under the limit by the end of the year, the president's budget office would be required to apply an across-the-board cut, or sequester."⁷¹

Also, a clear definition of what an emergency is in addition to putting on the record implicit and explicit guarantees issued by the federal government are also a must. These changes could help shrink the size of government over time.

While forces behind the political abuses of budget gimmicks are strong and pervasive, it is important to put an end to them. Political actions have real consequences. In this case, the main consequence is a level of spending that never ceases to grow. In fact, spending is growing faster each year. That too has consequences. In FY2010, the deficit of the United States so far has reached \$1.4 trillion or 10 percent of GDP. That's the deepest in the red this country has been since the Second World War.

But as we know, there is no free lunch. First, debt is very expensive. The more we borrow, the higher the cost of borrowing. Second, large and sustained deficits and debt inevitably cripple economic growth. A growing debt also sends signals to investors that we are becoming riskier borrowers, which could ultimately lead to higher interest rates.

Finally, if these growing deficits continue, there will come a time where we will embark on the most massive transfer of wealth from younger taxpayers to older ones in American history. It will be not just unprecedented but unfair—our children will have to pay for the decisions we make today.

For all these reasons, it is important to put an end to deceptive accounting so that the United States does not become the next Greece.

¹ That government debt should not exceed 60 percent of the country's GDP is one of the four convergence criteria set by the Treaty on European Union, Official Journal C 191, 29 July 1992, <http://eurlex.europa.eu/en/treaties/dat/11992M/htm/11992M.html>.

² See for instance, the Peterson-Pew Commission on Budget Reform, *Red Ink Rising: A Call to Stem the Mounting Federal Debt* (Washington, DC: Committee for a Responsible Federal Budget, December 2009), available at www.crfb.org. This paper calls for a target of 60 percent debt-to-GDP ratio by 2018. Also, economist Donald Marron's target is 60 percent by 2020.

³ See the blog post from Donald Marron, "How Governments Hide Their Liabilities," February 14, 2010, <http://dmarron.com/2010/02/14/how-governments-hide-their-liabilities/>.

⁴ Wikipedia, "Stability and Growth Pact," http://en.wikipedia.org/wiki/Stability_and_Growth_Pact.

⁵ Louise Story, Landon Thomas, Jr., and Nelson D. Schwartz, "Wall Street Helped to Mask Debt Fueling Europe's Crisis," *New York Times*, February 13, 2010, <http://www.nytimes.com/2010/02/14/business/global/14debt.html?hp>.

⁶ Ibid.

⁷ Charles Forelle and Susanne Craig, "Debt Deals Haunt Europe," *Wall Street Journal*, February 22, 2010, http://online.wsj.com/article/SB10001424052748704751304575079880217528948.html?mod=WSJ_hps_LEFTWhatsNews#articleTabs=article.

⁸ Ibid.

⁹ For a comprehensive analysis of the 1974 Act, see Allen Schick and Felix Lostracco, *The Federal Budget: Politics, Policy, Process* (Washington, DC: Brookings Institution Press, 2007): 18.

¹⁰ Robert Keith, *The Deeming Resolution: A Budget Enforcement Tool* (Washington, DC: Congressional Research Service, RL31443, August 9, 2004): 2. Available at http://assets.opencrs.com/rpts/RL31443_20040809.pdf.

¹¹ James V. Saturno, *Congress Point of Order* (Washington, DC: Congressional Research Service, June 15, 1999).

¹² Ben Broadbent writes, "Fiscal tightening need not be electorally costly, but it will test government unity," Goldman Sachs Global Economics, May 2010. Broadbent continues, "It is commonly assumed that cuts in government spending will be both economically painful and electorally costly. Neither is borne out in the data. We've written before about the limited (and sometimes positive) effects of spending cuts on economic growth, at least in open economies. Here we add some simple analysis on the electoral consequences and, like others, find no evidence that spending cuts reduce support for the incumbent government. If anything the opposite tends to be true." Among other evidence, the paper cites the three governments that executed the most high-profile expenditure-based deficit reductions in recent history and yet were re-elected: Ireland in 1987, Sweden in 1994, and Canada in 1994.

¹³ James L. Payne, *Budgeting in Neverland: Irrational Policymaking in the US Congress and What Can Be Done about It*, (Washington, DC: Cato Institute, July 26, 2006).

¹⁴ *Statutory Pay-As-You-Go Act of 2010*, HJ Res 45, 111th Cong., Public Law 111-139, (2010), <http://www.govtrack.us/congress/bill.xpd?bill=hj111-45>.

¹⁵ Veronique de Rugy and David Bieler, "Is PAYGO a No-Go?" *Mercatus on Policy* 73 (Arlington, VA: Mercatus Center, April 2010). Available at http://mercatus.org/sites/default/files/publication/MOP73_PAYGO_web.pdf.

¹⁶ Cheryl D. Block, "Budget Gimmicks," in *Fiscal Challenges: An Interdisciplinary Approach to Budget Policy*, edited by Elizabeth Garrett, Elizabeth A. Graddy, and Howell E. Jackson (Cambridge, UK: Cambridge University Press, 2008).

¹⁷ Veronique de Rugy, *The Never-ending Emergency: Trends in Supplemental Spending* (Arlington, VA: Mercatus Center, April 2008).

¹⁸ Congressional Budget Office, *Supplemental Appropriations in the 1990s* (Washington, DC: March 2001). Available at <http://www.cbo.gov/ftpdocs/27xx/doc2768/EntireReport.pdf>.

¹⁹ Author's compilation based on Congressional Budget Office, *Supplemental Appropriations in the 1970s* (1981), *Supplemental Appropriations in the 1980s* (1990), *Supplemental Appropriations in the 1990s* (2001), and *Supplemental Appropriations from 2000 to 2006* (2007). Dollar amounts are in nominal dollars and is net of rescissions (amounts reduced by legislation).

²⁰ Author's calculations based on Office of Management and Budget, *President's Budget for Fiscal Year 2007*, Historical Tables, Table 5.4. See also *supra* note 2.

²¹ See *supra* notes 2 and 7; see also James V. Saturno, *Emergency Spending: Congressional and Statutory Rules* (Washington, DC: Congressional Research Service, CR21035, October 3, 2001); and U.S. Government Accountability Office, *Supplemental Appropriations: Opportunities Exist to Increase Transparency and Provide Additional Controls*, GAO-08-314 (Washington, DC, January 2008): 12. Available at <http://www.gao.gov/new.items/d08314.pdf>.

²² There has also been an increase in the use of the “emergency” label in regular bills, but nothing like in the supplemental ones. See de Ruy, *The Never-ending Emergency*.

²³ Brandon Gustafson, “The No Pork Pledge,” (Washington, DC: Citizens Against Government Waste, September 30, 2005). Available at <http://www.cagw.org/ccagw/congressional-candidates-sign.html>.

²⁴ Phone interview with The Heritage Foundation’s Brian Riedl on May 1, 2006.

²⁵ Peter Cohn, “Lewis Eyes \$6 Billion Shift to Boost Domestic Programs,” *Congress Daily*, May 3, 2006.

²⁶ *Ibid.*

²⁷ Thomas Hungerford, *Supplemental Appropriations: Trends and Budgetary Impacts Since 1981* (Washington, DC: Congressional Research Service, RL33134, November 2, 2005): i, http://assets.opencrs.com/rpts/RL33134_20051102.pdf.

²⁸ *Ibid.*

²⁹ Thomas Donnelly, *The Military We Need: The Defense Requirements of the Bush Doctrine* (Washington, DC: AEI Press, 2005): 81–86.

³⁰ In the past, the first year of a war was funded through the supplemental process, but then the military costs would go through the regular defense budget. See de Ruy, *The Never-ending Emergency*.

³¹ Remarks of President Barack Obama—As Prepared for Delivery Address to Joint Session of Congress, Tuesday, February 24, 2009, http://www.whitehouse.gov/the_press_office/remarks-of-president-barack-obama-address-to-joint-session-of-congress/.

³² Alan K. Ota, “Obama To Seek GOP Support for WAR Funding Bill,” *Congressional Quarterly*, May 24, 2010.

³³ United States Senate, Glossary, Off-Budget entities, http://www.senate.gov/reference/glossary_term/off-budget_entities.htm.

³⁴ Department of Treasury, “A Citizen’s Guide to the 2009 Financial Report of the U.S. Government,” (Washington, DC: Department of Treasury, 2009): vii, <http://www.gao.gov/financial/fy2009/09frusg.pdf>.

³⁵ Tad DeHaven, “Put Housing GSEs in Budget and Privatize,” Downsizing the Federal Government blog, Cato Institute, February 25, 2010. Available at <http://www.downsizinggovernment.org/put-housing-gses-budget-and-privatize>.

³⁶ Gretchen Morgenson, “Future Bailouts of America,” *The New York Times*, February 13, 2010, <http://www.nytimes.com/2010/02/14/business/economy/14gret.html?scp=1&sq=phaup&st=Search>

³⁷ J.W. Verret, “Separation of Bank and State: The Bailout Meets Federal Budget Law,” *Brigham Young University Law Review*, forthcoming.

³⁸ Howell Jackson, “Counting the Ways: The Structure of Federal Spending,” in *Fiscal Challenges: An Interdisciplinary Approach to Budget Policy*, edited by Elizabeth Garrett, Elizabeth A. Graddy, and Howell E. Jackson (Cambridge, UK: Cambridge University Press, 2008).

³⁹ Department of Treasury, “A Management’s Discussion and Analysis: table 1,” (Washington, DC: Department of Treasury, 2009): 3, <http://www.gao.gov/financial/fy2009/09frusg.pdf>.

⁴⁰ Budget of the United States, FY2011, <http://www.whitehouse.gov/omb/budget/fy2011/assets/opm.pdf>

⁴¹ The Social Security Trust Fund is for the first time running a cash flow deficit, which means that there is not money with which the federal government could help itself.

⁴² Block, 54.

⁴³ Budget of the United States FY2011, “Advance Appropriations,” Appendix, p. 1369.

⁴⁴ *Ibid.*

⁴⁵ *Ibid.*

⁴⁶ Congressional Budget Office, Statement by Robert D. Reischauer Before the Committee on the Budget, US House of Representatives, June 3, 1992, <http://www.cbo.gov/doc.cfm?index=4938&type=0>.

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⁴⁹ Block, 50.

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⁵⁷ Budget of the United States FY2011, Summary Tables, Economic Assumptions, Table S-13, p. 177, <http://www.whitehouse.gov/omb/budget/fy2011/assets/tables.pdf>

⁵⁸ 1994-1996 Advisor Council on Social Security. <http://www.socialsecurity.gov/history/reports/adccouncil/report/append1.htm>

⁵⁹ Social Security Administration, “Summary of Performance and Financial Information FY2009,” (Baltimore, MD: Social Security Administration, 2009), <http://ssa.gov/pgm/FY09SummaryReport.pdf>.

⁶⁰ Department of Treasury, *Financial Statement of the United States*, Notes to the Financial Statements, p. 89.

⁶¹ Ibid.

⁶² Henry Aaron, “Social Security: Getting the Facts Right,” *The Fiscal Times*, March 28, 2010, http://www.thefiscaltimes.com/Blogs/2010/03/30/~/.link.aspx?_id=051F8AD4CBFB460CA9299EDA7F214366&z=z. Also see Paul Krugman, “About the Social Security Trust Fund,” blog post at Conscience of a Liberal, March 28, 2008. <http://krugman.blogs.nytimes.com/2008/03/28/about-the-social-security-trust-fund/>.

⁶³ Bernard Wasow, “Four Questions and Answers about the Social Security Trust Funds, the National Debt, and Sound Fiscal Policy,” (Washington, DC: The Century Foundation, 2005), <http://www.socsec.org/publications.asp?pubid=540>.

⁶⁴ Budget of the United States, FY 2000 Budget, Analytical Perspectives, p. 337.

⁶⁵ Department of Treasury, “A Citizen’s Guide to the 2009 Financial Report of the U.S. Government” (Washington, DC: Department of Treasury, 2009): v, <http://www.gao.gov/financial/fy2009/09guide.pdf>.

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⁷⁰ Congressman Lamar Smith, “Smith Introduces Bill to Reduce Deficits,” May 18, 2010, <http://lamarsmith.house.gov/Read.aspx?ID=1355>.

⁷¹ Chris Edwards, “Federal Spending Limit,” *Downsizing the Federal Government*, June 1, 2010. <http://www.downsizinggovernment.org/federal-spending-limit>.