Mercatus Center at George Mason University
SPENDING & BUDGET INITIATIVE

A TOOLKIT TO ANALYZE LEGISLATION IN ORDER TO REDUCE SPENDING

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INTRODUCTION

The federal government has a spending problem. Government outlays are out-running tax revenue at an accelerating rate, causing record budget deficits and mounting debt. Raising taxes, as some suggest, is not the answer: the tax increases needed to cover ever-rising government spending would stifle economic growth.

The U.S. Constitution grants Congress the power of the purse. Thus, members of Congress bear the ultimate responsibility for the spending problem and for its solution. This toolkit provides members and their staffs with tools to help them evaluate spending bills and start the process of reducing government spending.

WHY THIS MATTERS

Total federal spending in fiscal year 2010 reached $3.5 trillion. Tax revenues were $2.1 billion. To cover the difference between the two—known as the budget deficit—the government borrowed $1.3 trillion, contributing to a publicly held debt of about $9 trillion, which is nearly two-thirds the size of the U.S. economy (which is also known to economists as the annual Gross Domestic Product). Under either existing policies or the president's budget, spending will steadily outpace tax revenue over the next decade and beyond even if Congress enacts substantial tax increases. Increased federal spending will result in growing budget deficits and escalating government debt. The Congressional Budget Office (CBO) estimates that under the president's budget, the debt will reach $20.3 trillion in 2020, equivalent to about 90 percent of the economy.

The president's FY2011 budget would raise taxes by $3 trillion over the next decade—including a $743 billion health-care reform tax, an $843 billion cap-and-trade energy tax, a $968 billion tax on small businesses and upper-income families, and a $468 billion tax on corporations;[1] yet $3 trillion in new taxes won't cover all the new spending. As a result, the Office of Management and Budget projects the debt will double from $7.5 trillion in 2009 to $18.6 trillion by 2020.[2] Even a complete return to the higher, pre-2001 tax rates and expansion of the alternative minimum tax (AMT)—a $3.8-trillion tax increase over the next 10 years—would fail to catch up with the rapid growth of spending.

For the longer term, the problem only gets worse. Data from the Congressional Budget Office (CBO) project an exponential increase in spending over the next 50 years (see figure 1). Under a plausible scenario—assuming Congress continues recent policy choices—spending would exceed 35 percent of gross domestic product (GDP) by 2035 and then would keep on rising inexorably.

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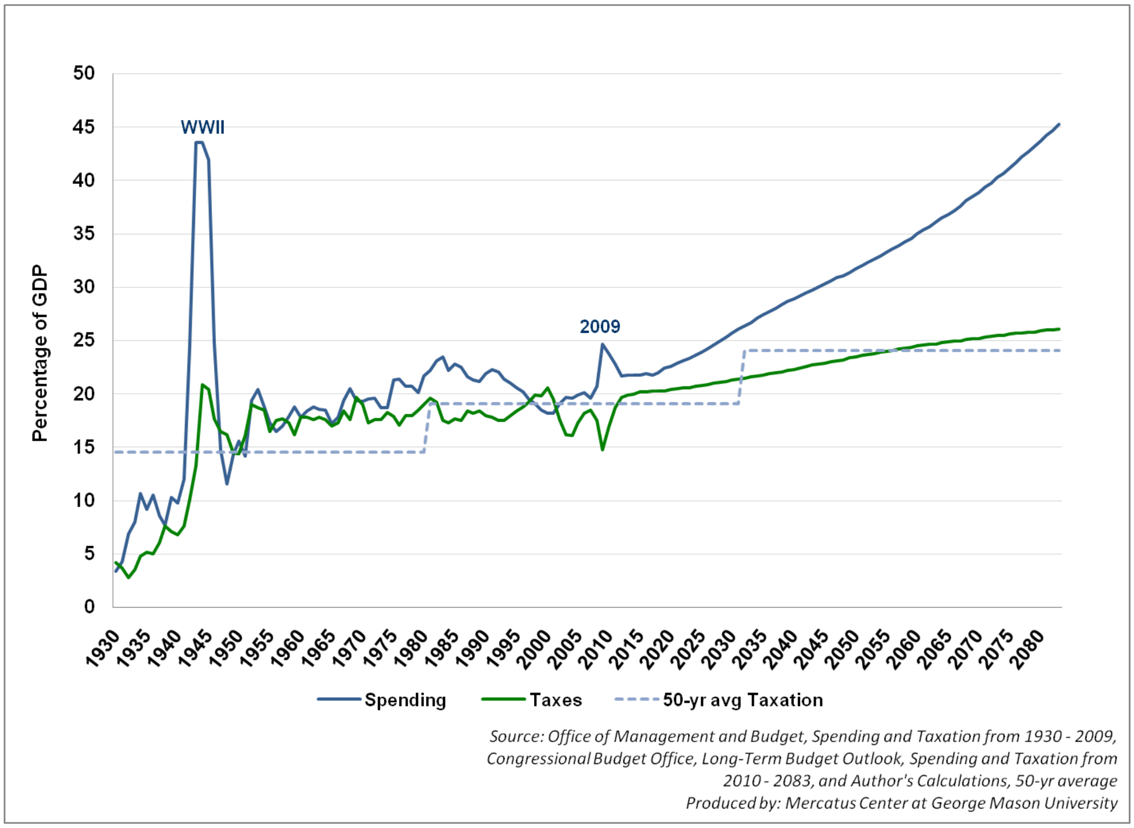
1 Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2011*, http://www.gpoaccess.gov/usbudget/fy11/pdf/budget.pdf.

2 Ibid, 146.

Figure 1: Long-Term Spending and Revenue Trends



The long-term budget problem cannot be addressed without spending reductions. The CBO estimates that tax rates would have to more than double to address the coming increase in spending.[3] These high tax rates would paralyze the economy. Robert Barro and Charles Redlick of Harvard University estimate that for each $1.00 in new tax revenue, the economy tends to shrink by about $1.10.[4]

Moreover, there is little reason to suppose that a revenue increase would solve the debt/deficit problem. Harvard's Alberto Alesina and Silvia Ardagna have examined numerous instances of fiscal adjustments throughout the world. They find that those attempts to close deficits that have relied on spending reductions have been far more successful than those that have relied on tax increases. Indeed, even a mix of spending reductions and tax hikes—the typical formula in most long-term budget proposals—is questionable because it may simply lead to less-than-adequate spending restraint as so often has happened in the past. Moreover, spending reductions are much less likely to lead to recessions than tax increases.[5]

QUESTIONS CONGRESS SHOULD ASK ABOUT THE SPENDING EFFECTS OF SPECIFIC BILLS

1. Does the bill increase spending?

2. Does the bill show favoritism or make exceptions for politically favored programs?

3 Congressional Budget Office, *The Long-Term Economic Effects of Some Alternative Budget Policies*, May 19, 2008, http://www.cbo.gov/ftpdocs/92xx/doc9216/Letter-to-Ryan.1.1.shtml.

4 Robert Barro and Charles Redlick, "Macroeconomic Effects of Government Purchases and Taxes" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2010).

5 Alberto Alesina and Silvia Ardagna, "Large Changes in Fiscal Policy: Taxes Versus Spending" (Harvard Institute of Economic Research, Discussion Paper no. 2180, Cambridge, MA, 2009).

3. Does the bill take advantage of the various accounting tricks and budget gimmicks used by the Congressional Budget Office (CBO), the Joint Committee on Taxation (JCT), the office of Management and Budget (OMB), and others to show a cost savings?

4. Does the bill alter the policy-making process to either encourage more or less spending in the future?

Criterion 1: Does the Bill Increase Spending?

To determine the effect of a bill on spending, the following questions should be asked:

1. If the bill claims to reduce spending, does it actually reduce it? Spending bills that are measured not against actual spending levels, but relative to an estimate of projected spending are called a "baseline." Consequently, often bills that only slow the rate of increase in spending can be falsely characterized by CBO, JCT, or OMB as reductions in spending. Similarly, a bill that simply cancels planned increases in spending may be a good first step, but it is not solution.

2. If this bill is an annual appropriation, does it increase spending over last year?

3. If the bill contains a request for additional funding, does it also contain an offsetting reduction in spending that is *within the committee's jurisdiction*?

4. Is the spending bill a one-time expenditure, or will it create ongoing expenditures?

5. How does the bill treat assumptions about productivity? The OMB requires agencies to submit a "Congressional Justification" report to Congress. In this report, it requires agencies to specify their funding requests within the context of offsetting productivity savings. Given technology improvements, economies of scale, and other factors, agencies may be able to achieve the same output as the previous year with fewer employees (FTEs—Full Time Equivalents in human-resource language). A productivity gain of 2 percent, for example, implies that given the same level of activity of the previous year, the agency should be able to do 2 percent more work at the same funding level.[6] It is important that congressional staff inquire with individual agencies about how the various productivity assumptions impact the budget request and program administration.

6. Is this bill designated as an emergency bill? Designating a spending bill as an "emergency" can exempt the spending from budget constraints. This could be a loophole for more spending if the spending bill isn't truly an emergency. What are the likely consequences of waiting until next year's appropriations process (is the emergency real)? Will the spending go away after the emergency ends? If it is an emergency, how will the additional spending be offset in the following year or two?

7. Does the bill request funding for a currently authorized program? If not, no funding should take place until and unless Congress authorizes the program (after an appropriate performance study). Moreover, appropriations should not happen in an authorization bill.[7]

8. What does this bill cost? There are two important costs in bills: costs to the U.S. government and social costs, which consumers and firms bear. If the CBO did the cost estimates, were there restrictions on how it did the estimates? For example, cost estimates can be "static," meaning that behavioral reactions to the bill might not have been fully accounted for (will taxing butter cause consumers to switch to margarine?), or "dynamic," where CBO factors into their cost estimates changes to consumer behavior (does a reduction in capital gains taxation lead to more capital invested and in turn higher economic growth?) . In most cases, members of Congress can request that

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[6] Office of Management and Budget, *OMB Circular No. A-11*, 2008, http://www.whitehouse.gov/sites/default/files/omb/circulars/a11/current_year/s51.pdf.

[7] Allen Schick, *The Federal Budget: Politics, Policy, Process* (Washington, DC: The Brookings Institution, 1995).

CBO supply an alternative score that takes into account behavioral reactions or macroeconomic impacts of policy changes.

9. If the bill creates new federal funding for state programs, will states have to pick up the cost once federal money is withdrawn? For example, a temporary increase in the Federal Medical Assistance Percentage (FMAP) to the states to cover increased Medicaid costs was included in the American Recovery and Reinvestment Act (ARRA). However, the assistance is only temporary and once it is withdrawn, states will have to either cut back on services or dramatically increase their own spending in order to maintain the services levels that were available under the temporary FMAP increase.

Criterion 2: Does the Bill Show Favoritism or Make Exceptions for Politically Favored Programs?

Real fiscal reform requires not just a change in the trajectory of government spending, but also a change in the political (or parochial) priorities of elected officials. For Congress to successfully cut spending, its solutions should not treat areas of the budget as untouchable. All parts of the budget must be on the table for review and potential cuts. Failure to do so will jeopardize the goal of addressing our fiscal problems. Thus members must ask themselves the following questions when they review a bill:

1. Does the bill exempt any portion of the federal budget from scrutiny?

2. Does the bill cater to a specific group?

3. Does the bill create a constituency for new spending?

4. Are the benefits of the bill concentrated on the few with the costs spread out over the many? If so, this can lead to a bias in favor of overspending because stakeholders who pay for the bill will find it harder to organize against it compared with stakeholders who benefit from the bill.

5. Are the benefits of the bill concentrated on a few and paid for by a different few? In other words, is there discrimination going on?

Criterion 3: Does the Bill Take Advantage of Accounting Tricks and Budget Gimmicks?

Various entities "score" all major spending and budget legislation. Congress uses estimates developed by the Congressional Budget Office or the Joint Committee on Taxation. The administration uses estimates from the Office of Management and Budget and sometimes the Treasury. Private economic-forecasting firms or think tanks develop estimates as well. Though these are not official estimates, they can help inform debate about the legislation.

Unfortunately, those who ask for the scores can game the system to distort the true impact of the legislation. Consider the following questions when looking for certain gimmicks:

1. Does the bill take advantage of certain "scoring windows"?

   Example: Congressional budget rules generally only consider a 10-year window when analyzing spending or revenue bills. A 10-year window allows policy makers to "game" the projection by front-loading or back-loading certain aspects of the legislation. For example, in the recently-passed health overhaul, taxes were to have been implemented immediately while expenditures were to have been implemented in 4 years. This meant that under the 10-year scoring window, the CBO accounted for 10 years of revenue and only 6 years of costs, making the bill appear to reduce the deficit. Members and staff should ask what the cost implications are outside of the scoring window.

2. Does the bill rely on unrealistic future political assumptions?

Example: Major legislation assumes that future policy makers will make the difficult decisions that current policy makers are unwilling to make. Take the recent health care legislation. That bill assumes that Congress will do something that it has been unwilling to do for nearly a decade: forgo the "doc fix."

Legislation passed in 1997 mandated that physicians would receive reduced reimbursements for serving Medicare patients. Since 2002, however, Congress has repealed these reductions, a practice that has earned the name the "doc fix." This practice may make doctors happy, but it has also increased overall Medicare spending. The recent doc fixes are estimated to exceed $200 billion over the next 10 years. Meanwhile, if Congress were to allow the physician payment reductions to actually take place, there would now need to be a 31 percent reduction from current payment levels to reach the target originally set. Not surprisingly, many physicians have said cuts that deep would lead them to stop taking Medicare patients. The recently passed health-care bill reduced its overall estimated cost and eased its passage by assuming the doc fix would take place. If Congress chooses not to implement the doc fix, the true cost of the health care reform law will be higher. Congress, however, has continued passing temporary doc fixes and almost surely will continue to do so. The current fix expires on December 31, 2011.

3. Does the bill rely on unrealistic economic assumptions?

Example: Major legislation assumes that the rate of economic growth will be higher than it is likely to be or/and that other economic indicators will be more favorable to its position than expected. For instance, in the middle of the recession, President Obama's budgets have systematically assumed very optimistic economic assumption. His first (2009) budget included a 3.2 percent GDP growth forecast for FY2010 at a time when the economy was shrinking.[8] As a result, OMB also projected a reduction in the unemployment rate from 7.6 percent at the time to 5.2 percent at the end of President Obama's term (FY2012), even though the rate at the time was 7.6 percent, and many economists correctly expected it to climb past 9 percent before the recession ended. Meanwhile, the White House assumed a much slower rate of consumer price inflation than private-sector economists between 2010 and 2012. This allowed the president to pencil in an 8 percent increase in revenue between FY 2010 and FY2011. It also allowed OMB to assume that by the end of the president's term, taxes collected as a percentage of the economy would reach 18.7 percent from the current 15.4 percent that year which in turns meant that the deficit would be reduced from $1.7 trillion to $581 billion.[9] These assumptions didn't materialize.

4. If the bill constrains the spending of future policy makers, does it allow them to avoid these constraints?

Example: Every state but Vermont has a balanced-budget requirement. In some states, however, the balanced budget legislation requires legislators to balance the budget only prospectively (in the coming years) and not retrospectively. Similarly, some balanced budget requirements permit legislators to "roll over" a deficit from one year to the next. These types of requirements give legislators enough wiggle room to evade the balanced-budget constraint.

This happens at the federal level too. Take the PAYGO rule that was adopted recently. As designed, it applies only 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. This application makes the rule almost irrelevant.

[8] *Budget of the United States, FY2010*, Summary Tables, http://www.gpoaccess.gov/usbudget/fy10/pdf/budget/summary.pdf.

[9] Ibid., table 1.

5. Does the bill have hidden costs?

   Example: Professional scoring agencies, such as the Congressional Budget Office (CBO), evaluate the explicit budgetary costs of legislation. Except in a few instances (such as the long-term fiscal outlook by the CBO), however, these agencies do not evaluate the hidden costs that legislation imposes on taxpayers. These hidden costs include regulatory compliance costs, crowding-out costs (when government activity displaces private-sector activity), and other forms of economic loss. Asking CBO and other scoring entities to consider costs above and beyond the explicit budgetary costs would help shed light on some of the unseen costs imposed by legislation. Members should also consult professional economists who can estimate the size of these sorts of hidden costs.

Criterion 4: Does the Bill Alter the Policy-Making Process to Encourage More or Less Future Spending?

Typical legislation changes spending patterns by either increasing or reducing certain agencies' budgets. Succeeding Congresses can easily alter this type of legislation and often do, restoring the budgets of programs that a previous Congress had cut. However, legislation that alters the actual policy-making process to encourage more or less spending can affect policy for decades. Consider, for example, the Congressional Budget and Impoundment Control Act of 1974. This act established the CBO, created the House and Senate Budget Committees, and set the procedures for legislative oversight of impoundments. Together, these changes dramatically reshaped budgets for decades.[10]

Procedural or institutional reform like Congressional Budget and Impoundment Control Act of 1974 could have a profound and lasting impact on spending. The questions below would help legislators think through these process reforms.

1. Does the reform give future policy makers an incentive to support major spending legislation? Consider, for example, the practice of congressional earmarking. Although earmarks are a relatively small portion of the budget, some have suggested that their existences have "greased the wheels" of the spending process, because congressional leadership can secure majority votes for expensive legislation by promising earmarks to members who vote in support of it.

2. Does the reform give future policy makers an incentive to reduce spending? Certain transparency reforms may reduce spending by shedding light on the most profligate members of Congress.

3. Does the reform force policy makers to account for the costs and benefits of legislation? Requiring regulatory or economic impact statements may discourage policy makers from enacting legislation with lots of hidden costs.

4. Does the reform make it harder for policy makers to concentrate benefits on some and diffuse the costs over the many? For years, some analysts have interpreted the "general welfare" clause of the Constitution to mean that legislation benefiting specific groups was unconstitutional. Once policy makers and courts began to interpret "general welfare" more loosely, it opened the door for costly programs that benefit specific groups at the expense of others.

5. Does the reform make it harder for policy makers to pass costs on to future generations? States with strict balanced-budget requirements spend less than states with weak requirements.[11] This is likely because taxpayers will support larger budgets when they can pass the cost of these budgets off on to future generations. Members should ask whether proposed legislation makes it easier or more difficult to pass costs on to future generations. To the extent that they can make more difficult to pass costs onto future generations, they will discipline policy makers to rationally weigh all costs and benefits.

[10] Allen Schick, *The Federal Budget*.

[11] David Primo, *Rules and Restraint: Government Spending and the Design of Institutions*. (Chicago: University of Chicago Press, 2007).

KEY MERCATUS SCHOLARS

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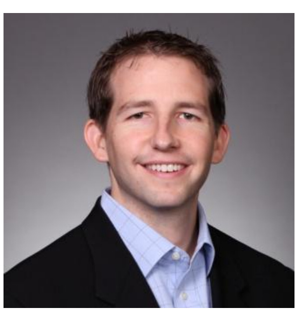

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KEY MERCATUS RESEARCH FINDINGS

- Jerry Brito, "Running for Cover: The BRAC Commission as a Model for Federal Spending Reform" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2010).
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