

Setting and Achieving Responsible Fiscal Goals

*Testimony before the House Budget Committee
Congressional Budgeting: The Need for Fiscal Goals*

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Thank you Chairman Price, Ranking Member Van Hollen, and members of the committee for inviting me to testify on the subject of fiscal goals. Before joining the Center for American Progress, I worked on budget, tax, and national security policy here on Capitol Hill as a legislative assistant to Senator Herb Kohl, and it is an honor and a privilege to contribute to this committee's efforts to identify and achieve better goals for fiscal policy.

Fiscal policy exists within the context of economic policy, and fiscal goals should help the United States achieve national goals. Fiscal policy is where lawmakers make choices about how the government will collect and deploy resources. This means deciding which national goals the federal government will prioritize, such as job creation, retirement security, national defense, or public health.

Responsible fiscal goals should set a course to achieve the national goals that lawmakers have chosen to prioritize, and ensure that resources are available to deliver on those promises. Fiscal goals should be determined based on economic conditions, with flexibility for policymakers to respond decisively to new developments. Fiscal policy should help smooth the ups and downs of the business cycle to help American families deal with economic shocks.

It would be an understatement to say that the nation's fiscal policy has been less than ideal in recent years, and my testimony will offer some suggestions for improving our fiscal goals and outcomes. In the current economic climate, we are missing a golden opportunity to use expansionary fiscal policy to grow the economy and increase opportunities for American workers. And in the long-run, lawmakers will have to adjust fiscal policy to sustain health care and retirement programs as the population ages.

My testimony also cautions against the misuse of fiscal goals. The most robust exercise of Congressional powers to tax and spend occurs via the normal legislative process. This includes appropriations bills and legislation to modify mandatory spending and tax programs. Separation of powers and political polarization are the primary barriers that prevent proposed fiscal changes from becoming law. Rigid fiscal rules result in Congress delegating a portion of its powers of the purse and taxation to other entities, and these rules increase the negative consequences of political polarization for the American people.

Fiscal goals should help achieve national goals

Fiscal policy provides lawmakers with a set of tools to build a stronger and more resilient nation. In the broadest sense, these tools are taxing, spending, and borrowing. Fiscal goals should guide the effective use of these tools to defend the nation, grow the economy, increase living standards, and make progress on other national priorities.

A federal budget that responds to the economy is an important source of national strength. Looking at fiscal and economic data going back to 1870, Jared Bernstein and Richard Kogan have found that American economic growth has been stronger and less volatile ever since the federal government increased the use of borrowing as a tool to respond to fluctuations across the business cycle.¹ Some of this fiscal response is due to automatic stabilizers, such as unemployment insurance and the progressive income tax, which cause higher deficits in weaker economies and lower deficits in stronger economies.²

Fiscal policymakers should consider economic indicators such as growth, wages, interest rates, and inflation to inform their use of fiscal policy tools. One serious problem to consider is that the benefits of economic growth have not been reaching working Americans. While overall productivity increased by an average of approximately 2% per year from 2001 to 2015, typical workers have only seen annual wage increases of less than 1%.³ Labor markets have not tended to operate at full employment for the last several decades, which is holding back economic growth, increasing inequality, suppressing wages, and undermining the nation's fiscal health.⁴

The Congressional Budget Office (CBO) reports that the economy has not been working at its full capacity since 2008.⁵ When the economy is running below its potential due to low demand, CBO states that increasing demand with expansionary fiscal policy—which means higher budget deficits in the short-term—is particularly effective to grow the economy.⁶

At the same time, inflation and interest rates have fallen to unusually low levels. On June 9, 2016, interest rates on 5-year treasury bonds were 1.22%, or -0.31% after adjusting for inflation.⁷ Since 2001, the annual inflation rate has averaged 1.7% as measured by personal consumption expenditures excluding food and energy.⁸

Based on these economic indicators, expansionary fiscal policy is the best course for growing the economy. The United States is wasting economic resources by leaving them idle. In May 2016, nearly 1.9 million American workers had been out of work despite trying to find a job for at least 27 weeks.⁹ Failing to address this long-term unemployment crisis has a terrible human cost for American workers and their families, and it also causes lasting damage to the economy. This is one reason that CBO has reduced its estimates for the nation's long-term potential economic output.¹⁰

Expansionary fiscal policy is especially important as a tool to increase demand and support full employment when interest rates around the world are stuck at very low levels.¹¹ A recent paper by former CBO director Douglas Elmendorf and economist Louise Sheiner points out that, "Persistently low interest rates reduce the ability of the Federal Reserve to reduce rates in recessions, which increases the importance of countercyclical budget policy."¹²

One simple fiscal goal that should have bipartisan support is to increase infrastructure investment. The American Society of Civil Engineers reports that American roads, transit, and water systems are in poor condition, and gives overall American infrastructure a grade of D+.¹³ A great place to start would be to work with households and utilities to replace the lead service lines that deliver drinking water to between 15 million and 22 million Americans.¹⁴

At a time when investors are effectively paying for the privilege of giving a 5-year loan to the United States, this is the ideal time to put Americans back to work rebuilding our infrastructure. Lawmakers should also ensure that these infrastructure dollars are spent as efficiently as possible, in part by increasing accountability for how federal transportation funds are spent at

the state level.¹⁵ Failing to invest in our infrastructure now means leaving a larger deficit of deferred maintenance to future generations.

To be clear, expansionary fiscal policy is not always appropriate. Policymakers should continuously monitor economic conditions and adjust fiscal policy as necessary. CBO's frequent updates to the budget and economic outlook are an invaluable resource for Congress to craft effective fiscal policy.

In the long-term, another important goal for fiscal policy is to meet the needs of an aging population. The current tax code does not raise sufficient revenue to sustain programs such as Social Security and Medicare as the population ages, although we have made significant progress to reduce Medicare spending projections and make the program more efficient. Lawmakers will have to set fiscally sustainable goals for retirement security and tax policy.

The Center for American Progress has proposed a comprehensive and fiscally sustainable long-term budget plan that substantially increases public investment, reduces mandatory spending growth with a focus on controlling health care costs, and ensures that the wealthiest Americans and corporations pay their fair share in taxes.¹⁶ Our plan also demonstrates that there is no fiscal imperative to cut Social Security, and even includes a modest increase in Social Security benefits for low-income retirees.

The good news is that markets have full confidence in American fiscal strength, and long-term deficits do not present an immediate crisis. As of June 9, 2016, investors were willing to extend a 30 year loan to the United States at 2.48% interest, or less than 1% after adjusting for expected inflation.¹⁷ Elmendorf and Sheiner conclude that "the response to the high level of debt and to population aging should be quite gradual."¹⁸

Lawmakers have many options to reduce deficits over the long-term, and should consider their choices carefully. Rigid fiscal rules may provide a tempting way to force subsequent policy changes, but fiscal goals that are disconnected from broader national goals and set in an arbitrary fashion are not responsible fiscal policy.

Recent experience has shown that it is easy to set huge goals for deficit reduction without following through. The super-committee established by the Budget Control Act of 2011, for example, failed to agree on a plan to achieve the deficit reduction target established by that law.¹⁹ And as the Committee for a Responsible Federal Budget has reported, lawmakers made policy choices in 2015 that increased deficits, despite the fact that Congress passed a budget resolution which set a goal of balancing the budget within 10 years.²⁰

The appropriations process in 2013 also illustrates the failure of fiscal goals that are not rooted in national goals. In the midst of across-the-board sequestration cuts, the House of Representatives set a goal to make even deeper cuts to nondefense discretionary programs for fiscal year 2014. The appropriations process broke down that year when the House failed to pass a spending bill for transportation and housing programs that made deep cuts in an attempt to carry out this goal.²¹ House Appropriations Committee Chairman Harold Rogers said that, "With this action, the House has declined to proceed on the implementation of the very budget it adopted just three months ago."²²

Ultimately, the government temporarily shut down in 2013 after lawmakers failed to pass appropriations bills. The situation was only resolved after a bipartisan budget agreement set more reasonable targets for discretionary programs.²³

Rigid fiscal rules reduce lawmakers' control over taxes and spending

There is no area of the budget over which lawmakers do not exert direct authority. Even though Congress does not fund mandatory spending programs such as Social Security in annual appropriations bills, lawmakers can change these programs at their discretion using the normal legislative process. While setting rigid fiscal goals is one way that Congress can change the course of taxes and spending, this would be a process that transfers fiscal policy choices to the Executive Branch, the Judicial Branch, or some other entity.

There are some cases where lawmakers have chosen to transfer a set of fiscal choices to an outside entity. A Base Realignment and Closure Commission (BRAC), for example, compiles a set of changes to military installations and takes control over individual base closure decisions out of the hands of Members of Congress focused on protecting jobs in their district. The Affordable Care Act (ACA) authorizes the establishment of the Independent Payment Advisory Board (IPAB), which has the power to make changes to federal health care programs if cost growth exceeds the limits established in the law. And in 2013, it was the responsibility of the Executive Branch to determine how to implement sequestration.

One frequently discussed policy option is amending the Constitution to enforce the fiscal goal of a balanced budget. This rigid requirement would prevent lawmakers from responding decisively to emergencies, wars, or recessions. Instead, during tough economic times it would force sudden increases in tax rates to make up for falling revenue collections or painful cuts to programs such as unemployment insurance and nutrition assistance that automatically expand to meet increased needs. Additionally, as former circuit court judge Robert Bork points out, a balanced budget amendment to the Constitution inappropriately outsources fiscal policy to the federal courts.²⁴

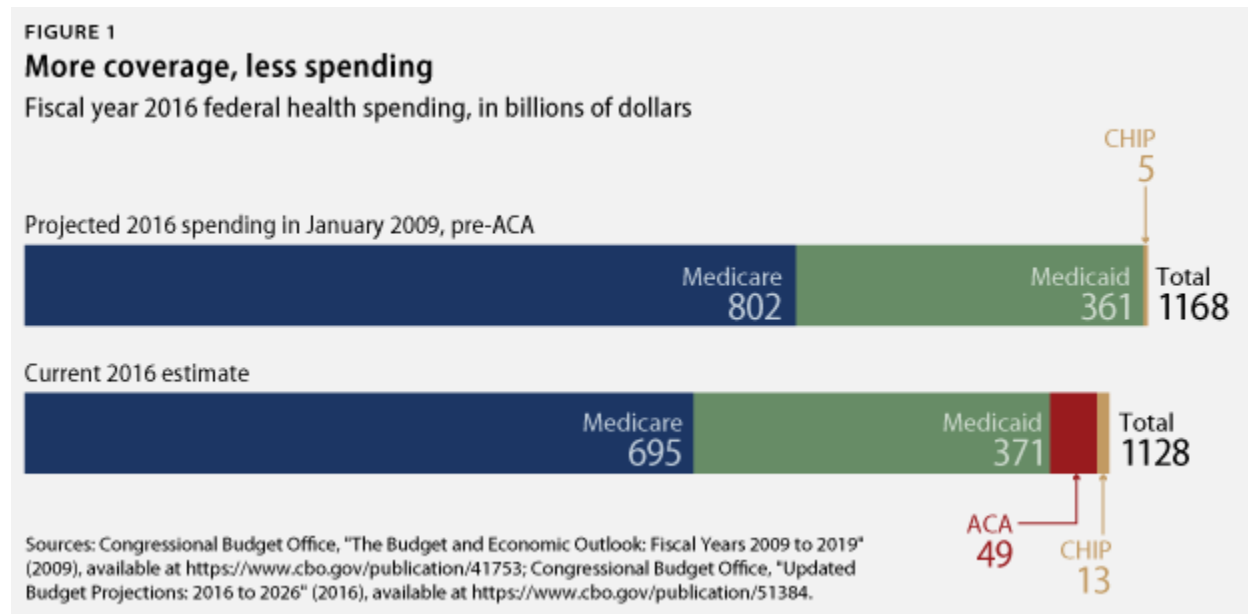
Even if a fiscal rule does not look to the Judicial Branch for enforcement, Congress surrenders its fiscal prerogatives by including any type of automatic trigger to force a particular outcome. Automatic spending cuts, for example, mean that Congress is not exercising its power of the purse to determine where to cut and where to invest. For this reason, Admiral Mike Mullen has characterized sequestration as showing a lack of responsibility for sound fiscal and national security policy.²⁵

Lawmakers do not need rigid fiscal rules to change mandatory spending programs, which have been modified quite frequently by Congress in recent years. This includes legislation to reauthorize and modify mandatory programs for transportation and agriculture.²⁶ And the most significant changes to mandatory programs have been in health care.

Congress recently enacted Medicare reforms in legislation that replaced Medicare's Sustainable Growth Rate formula, and made sweeping reforms to Medicare and Medicaid in the ACA.²⁷ At the same time that the ACA expanded health coverage and the uninsured rate fell to record lows, overall health care spending has become substantially more efficient. Medicare spending projections have fallen dramatically—including the long-term projections in which CBO assumes cost growth will return to more normal levels—which is due in part to the Medicare reforms in the ACA.²⁸

Federal spending on major federal health care programs in FY 2016 will be lower than the FY 2016 projections that CBO published before President Obama took office in 2009 (See Figure 1).²⁹ Of course, those earlier projections did not include the coverage expansion in the ACA that

helped over 20 million Americans get health insurance. Federal health care programs are covering more people for less money.



Many lawmakers may oppose the ACA or other recent legislation affecting mandatory programs, but these laws prove that Congress and the President can and do shape fiscal policy using the normal legislative process. Other unsuccessful attempts to change fiscal policy have not failed because the budget process doomed them to failure, but because they lacked sufficient support in our Constitutional system, which separates powers by distributing them among the three branches of government.

Polarization is the primary barrier to changing fiscal policy

Similar to earlier years, President Obama's budget recommends investing in infrastructure and clean energy, supporting education and scientific research, and strengthening anti-poverty programs.³⁰ To enable some progress to be made on these investments and other economic and national security initiatives, President Obama recommends lifting the sequestration spending caps. Congressional budgets have also tended to call for increasing spending above sequestration levels, but only for defense programs.³¹

Congress and President Obama have been able to agree on modest increases to the sequestration caps, which has been a positive development towards improving fiscal policy. However, these measures have not even been sufficient to fully repeal sequestration, much less to enable the levels of investment that are truly needed in sectors such as infrastructure. The limited scope of these budget deals has been due to high levels of disagreement and polarization regarding fiscal policy.

President Obama and Congress also agree on the goal of reducing long-term deficits, and it should be noted that deficits have already fallen from 9.8% of GDP in 2009 to 2.5% of GDP in 2015.³² If President Obama's FY 2017 budget were enacted into law, CBO estimates that deficits would decline by roughly \$2.4 trillion over the next 10 years.³³ While neither chamber of Congress has passed an FY 2017 budget resolution to establish fiscal goals, last year's

congressional budget resolution called for balancing the budget within 10 years.³⁴ The lack of additional action to reduce long-term deficits has not been due to a lack of ambitious goals.

The problem is polarization. President Obama and Congress disagree on fiscal policy, and fiscal policymaking requires compromise in the current political environment. When bipartisan commissions have put forward plans for long-term deficit reduction, those plans include a mix of spending cuts and tax increases. Organizations such as the Committee for a Responsible Federal Budget and the Concord Coalition stress that lawmakers must be willing to compromise on both the spending and revenue sides of the budget.³⁵

Spending projections have already fallen dramatically in recent years. Total federal spending in FY 2015 was \$562 billion less than CBO projected it would be in August 2010.³⁶ The measures taken by lawmakers to reduce deficits have been heavily tilted towards spending cuts. According to the Office of Management and Budget, there have been \$3 in spending cuts from enacted legislation since 2011—not including interest savings—for every \$1 of tax increases.³⁷

Unfortunately, a majority of the members of the House of Representatives have signed a pledge swearing to oppose any tax increase, even as part of a compromise to reduce long-term deficits.³⁸ While the recent budget deals have included modest reforms to increase revenue alongside spending cuts, no major fiscal compromise is possible as long as significant revenue changes are kept off the table.

In contrast, President Obama, House Minority Leader Nancy Pelosi, and Senate Minority Leader Harry Reid have all stated that they are open to fiscal compromises that include spending cuts.³⁹ And in his most recent budget proposal, President Obama offers specific policies to make significant reductions in mandatory spending programs, along with proposals to increase revenues.⁴⁰

This trend of increasing polarization has been studied closely by leading congressional scholars Thomas Mann and Norman Ornstein. The two scholars note that President Obama has endorsed many of the policies that might be included in a fiscal grand bargain, and warn journalists, scholars, and “self-styled nonpartisan and bipartisan groups” that ignoring the asymmetry of intransigence between the two parties hinders efforts to improve governance. Ultimately, Mann and Ornstein conclude that, “a BRAC-like mechanism is not well-suited for resolving deep differences on the broad issues of taxes and spending, particularly with the Republicans so deeply dug in—substantively and politically—to their position on tax increases.”⁴¹

Rigid fiscal rules using cliffs and triggers do not make polarization disappear, but they do increase polarization’s negative consequences. Fiscal cliffs create new hostage-taking opportunities for lawmakers to attempt to force policy changes that the political system would not freely accept. We already have ample experience with these manufactured fiscal crises, such as threats to default on the national debt by refusing to increase the debt ceiling, shutting down the government to demand repeal of the ACA, and automatic sequestration cuts that were supposed to force lawmakers to accept a fiscal grand bargain. Budget process reforms should focus on reducing—not increasing—opportunities for political hostage-taking.

Conclusion

Fiscal policy provides powerful tools to use in service of our national goals. The process of setting fiscal goals should help ensure that those tools are put to good use. I hope that my

testimony will be helpful to this committee's consideration of fiscal goals, and I look forward to answering your questions.

Endnotes

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