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Budget Reforms Embodied in S. 101, the Honest Budget/Balanced Budget Act

Statement of
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Before the
Committee on the Budget
United States Senate

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Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss S. 101, the Honest Budget/Balanced Budget Act. Dealing with the budget deficit requires relevant information on the true state of the government's finances--information that is now lacking or which is difficult to ascertain. Changes in budget presentation, such as those embodied in S. 101, represent efforts to improve this situation. The question is, what information is most meaningful and relevant in helping to address the deficit problem. The answer to this question is a matter of considerable debate. The budget structure proposed in S. 101 is one option.

PROVISIONS OF S. 101

S. 101 specifies that the budget of the United States would be a unified budget composed of (1) a Retirement Funds Budget, (2) an Operating Budget, and (3) a Debt and Interest Budget. The Retirement Funds Budget would include receipts and expenditures for such trust funds as Social Security, Medicare, and Civil Service Retirement. The Debt and Interest Budget generally would include receipts and expenditures for changes in the level of the public debt and for interest on that debt. The Operating Budget would include all receipts and outlays not included in either of the other two budgets.

S. 101 requires that the President submit a balanced Operating Budget, with the exception of the costs of federal deposit insurance. It also specifies points of order against House or Senate consideration of a concurrent resolution or amendment which would cause an unbalanced Operating Budget. Notwithstanding these requirements, if the deficit exceeds the maximum deficit amount, the Operating Budget for the following year would include an expenditure equal to the previous year's excess. During time of declared war or declared recession, Treasury borrowing would be permitted in the Debt and Interest Budget, which would then be transferred to the Operating Budget as receipts to maintain the Operating Budget in balance.

S. 101 redefines the term "deficit" to be the amount by which the combined outlays of the Operating and Debt and Interest Budgets exceed their receipts, generally corresponding roughly to the increase in the gross federal debt. Retirement Fund surpluses would not be included in any calculation of the deficit. S. 101 also provides for the creation of a trust fund for the reduction of the deficit and the public debt and provides for enactment of dedicated debt-reduction taxes.

I believe that the idea of focusing attention on specific parts of the budget is a good one. Our national leaders and the public need to understand the true nature of the deficit problem. This requires a recognition that different parts of the budget move in different directions and that federal dollars are spent or invested in a variety of ways that can, over time, have vastly different consequences when it comes to fiscal policy. The unified federal budget as presently constructed focuses attention primarily on the total cash deficit. This dominating concentration on each year's cash deficit in isolation, reinforced by the Gramm-Rudman-Hollings law, has diverted attention from a careful examination of the components of the budget.

Not only are those components important in their own right, but understanding them is essential if we are to develop effective policies for dealing with the deficit itself. For example, merging the growing trust fund surpluses into the general budget total gives the impression that the deficit problem is being corrected when, in fact, it is just being hidden. Also, large, business-type operations like the Postal Service are unable to plan and operate efficiently because they are subject to annual spending controls because of the budget's year-to-year focus. Finally, critical capital investments are postponed because the budget, with its focus on cash outlays, treats them the same as it treats spending on consumables like paper and pencils.

S. 101 focuses attention on retirement funds and the debt and interest components of the budget. This would be a marked improvement over the current situation and we agree that these are important distinctions that should be made. In particular, we agree with the emphasis that S. 101 gives to the deficit excluding the retirement fund surpluses by focusing on the increase in the gross federal debt. We have been emphasizing a comparable measure of the deficit--that in the federal funds part of the budget. In our work over the past few years, however, we have come to the conclusion that there are other important components of the budget that should also be given heightened visibility in a restructured budget.

GAO's RESTRUCTURED BUDGET

GAO in the past has proposed retaining the unified budget but supplementing its single "bottom line" focus by prominently displaying information that clearly differentiates general government, trust fund, and enterprise-type activities. Each of those three components would be further broken down to show capital investments separately from operating costs. I have discussed this proposal with this committee before, but would like to take this opportunity to review briefly the rationale for such a restructured budget. To help you visualize our proposal, we have attached an illustration at the end of this statement. (See attachment I.)

Merging most of the current trust fund surpluses--which are predominantly the retirement funds that S. 101 identifies--into the general budget total hides the general fund deficit. While the total budget deficit is projected to decline over fiscal years 1992 through 1996, much of the decline is due to the growing retirement trust fund surpluses. Despite the Budget Enforcement Act, the general fund deficit is projected by the Congressional Budget Office to remain above $300 billion at least through 1996. Only when this deficit is combined with the trust fund surpluses will the total deficit go below $200 billion. If the status of trust funds was shown separately from general government funds as proposed in GAO's restructured budget, lawmakers and the public could more easily understand the underlying nature of the deficit.

We are working to develop a new definition of trust funds that would best disclose what is happening in the budget. A distinction made in the conference agreement for the Budget Enforcement Act may provide a basis for a new classification. It treats the outlays of some trust funds as discretionary and requires that their level be controlled through the appropriations process. These include principally the highway and airport and airway trust funds. The conference agreement classifies many other trust funds as mandatory spending accounts, including the retirement trust funds identified in S. 101. Our current thinking is that the trust fund label may best be used for, essentially, the latter kind of trust funds. These are accounts that finance entitlements with dedicated taxes.

I would also like to see a distinction made between regular government operations and such federal enterprise-type activities as the Postal Service and the Tennessee Valley Authority. Many of these activities are intended to be largely self-supporting, and to accomplish their missions, they require flexibility for making investment and spending decisions. While such entities should be subject to budgetary scrutiny and control, it is shortsighted to treat their investment and operating decisions (which could increase their long-term earnings) in the same way we treat salaries and expenses in a regular government agency.

The Office of Management and Budget (OMB) is in the process of identifying the government's commercial activities for financial statement reporting purposes as specified in the Chief Financial Officers Act. We will be keeping abreast of their efforts and evaluating the resulting list for its use in GAO's restructured budget. It would be desirable for OMB and GAO to agree on the entities to be considered commercial and for that group of entities to comprise the enterprise part of GAO's restructured budget.

Finally, I believe we should make another distinction that the unified budget structure obscures: the distinction between regular operating expenses and long-term investments. Most states and private companies make a distinction between routine operating costs, which cover salaries and day-to-day expenses, and investments in buildings, computers, and highways--the latter being expenditures for things that will enhance productivity or produce income over a number of years. The federal cash-based budget, on the other hand, treats all expenditures in the same manner. For example, it makes no distinction between the cost of fuel for airplanes or government automobiles (an operating expense) and the cost of constructing a new highway (an investment).

The United States will not be competitive in the future world economy without sufficient investments in new factories, highways, research, education and all the other factors that go into raising the productivity of our labor force. We need to save and invest today so that our children and grandchildren can sustain a rising living standard and also support a large retired population. However, our budget policies over the last ten years have favored consumption over investments. Huge federal deficits have consumed private savings that could have been devoted to new plants, equipment, and other productive private investments. Also, the government has not invested sufficiently in highways, education, research and other public investments. To ensure that Americans continue to enjoy a standard of living comparable to other industrial nations, we must increase savings and investment.

There are two ways in which budget decisions can help solve this national savings/investment problem. One is by eliminating the deficit and moving to an overall budget surplus as we recommended in our report[1] a year ago to free up capital for

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[1]The Budget Deficit: Outlook, Implications, and Choices (GAO/OCG-90-5, September 12, 1990).

private investment. The other is by shifting the composition of federal spending to devote a larger portion to investment. The need to focus attention on this latter choice is one of the reasons we believe it is necessary to distinguish operating costs from investment in a restructured budget.

CONCERNS ABOUT S. 101'S BALANCED OPERATING BUDGET REQUIREMENT

S. 101's requirement that the President submit a balanced operating budget, except for the costs of deposit insurance, raises questions about the relationship between the legislative and executive branches. In the past, the executive branch has resisted efforts to require the President to present proposals to the Congress not supported by the administration. As a matter of comity, it may be undesirable to make such a submission mandatory. As a practical matter, this requirement does not prevent the President from submitting alternative proposals, so it cannot be expected to produce the intended result.

The desirability of a balanced operating budget varies depending on the national savings rate. The Social Security and other retirement trust funds are producing a surplus of about 2 percent of GNP and are adding that amount to the national savings. Under current economic conditions, we need this addition to national savings, and thus a balanced operating budget is a reasonable goal. Under different economic conditions, it may be less desirable.

Furthermore, even if S. 101's proposal were enacted, deposit insurance costs should not be excluded from the deficit calculation. S. 101 sets up a special category called "unanticipated expenses" within the operating budget and specifies that this category is only for deposit insurance costs, which will not be counted against the deficit. Experience has shown that there are always unanticipated costs. We believe that the federal budget should include all costs and revenues related to federal activities, including unanticipated expenses, in measuring the deficit.

S. 101'S DEBT RETIREMENT TRUST FUND

I understand the rationale behind creating a mechanism to provide for the enactment of taxes dedicated to debt reduction, such as S. 101's Debt Retirement Trust Fund. Public support for increased taxes is minimal, but may be stronger if the public perceives the taxes going directly to reduce federal debt. However, specifying that particular tax revenues will be used to reduce the debt does not automatically mean that the amount of debt will decline. The amount of debt will continue rising until total revenues exceed total outlays. This means that hard choices about the appropriate services to be provided by the government and how to pay for them must still be made.

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In summary, I think that S. 101 contributes to the needed debate over changes in the way the federal government goes about budgeting. Fundamental changes are needed, and S. 101 is one way to look at the budget. We need to consider others, including GAO's proposed restructured budget, as part of our effort to change the way we think about resource allocation in this country. I applaud S. 101 as a starting point for this dialogue.

ATTACHMENT I

PRESIDENT'S FY 1992 BUDGET RESTRUCTURED
ACCORDING TO GAO PROPOSAL

(dollars in billions)

	Total	General	Trust	Enterprise
Operating surplus/deficit (-)	-250	-402	146	6
Capital financing requirements	-31	-33	8	-6
Unified budget financing requirements	-281	-435	154	1

Note: Numbers may not add due to rounding.