Richard Emery

Fiscal procedures and institutions in the United States

This statement has been prepared for the Conference on Good Governance and Effective Partnership, organized by the Ministry of Finance of Hungary and the National Bank of Hungary. My comments will review fiscal discipline in the US and our experience with deficit based rules and expenditure rules. I will also provide an overview of transparency in the US budget process, focusing on the two institutions where I spent most of my professional career, the Office of Management and Budget (OMB) and the Congressional Budget Office (CBO).

OVERVIEW OF THE US BUDGET SYSTEM

The US budget process is different from most other OECD countries. The primary cause of the difference is the separation of powers established by the US constitution. In parliamentary systems, the government is supported by the majority party in parliament. A conflict over the budget could cause a government to fall. The US budget system is characterized by a strong Congress and by a system that creates conflict over the budget.

Political control over the budget is shared by two parties, the republicans and the democrats. The nature of the budget debate changes depending upon whether the party of the President controls one or both houses of the Congress. At the beginning of the Clinton Administration, the President, a democrat, had both a democratically controlled House and Senate to work with. He successfully pushed a major deficit reduction bill, cutting projected deficits by over $500 billion over five years. Not one republican voted for that proposal. For the last several years of the Clinton Administration, both the House and Senate were controlled by the republicans. The President stopped deep cuts in spending and stopped tax cuts proposed by the republicans by vetoing legislation.

In the US, first the Congress passes a budget resolution that establishes budget aggregates to guide subsequent bills. The budget resolution serves as a procedural constraint to legislative action on spending or tax proposals. Afterwards there is not a single budget bill. In contrast, the budget is enacted in 10 to 15 appropriations and numerous spending and tax bills. The President transmits a unified budget for the government.

Current operations of the US government are financed by 10 to 15 annual appropriations bills. Because this spending is determined annually, it is referred to as “discretionary” spending. Appropriations bills are organized by government agency or groups of agencies. The

Congress considers approximately 1,000 discretionary budget accounts and specifies funding for approximately 10,000 programs, projects and activities. For fiscal year 2007, the last Congress completed only two appropriations bills, funding the remainder of the government through an omnibus bill at prior year's levels.

Over 60 percent of the Federal budget funds mandatory or entitlement programs. Eligibility for these programs is established in law. Benefits must be paid, if a beneficiary meets the criteria established in law. Examples of entitlement programs are Social Security which provides income support to the elderly and Medicare, which provides health care for the elderly. To reduce the budget, the legislation authorizing the benefits must be amended. The remaining budget is controlled through annual appropriations bills, or is viewed as discretionary. In 1962, over 67 percent of the budget was discretionary. By 2012, just five years from now, mandatory spending is expected to grow to almost 70 percent of the federal budget.

Borrowing to cover deficits has not been a major issue to the US. US debt held by the public amounted to over $4.8 trillion by the end of fiscal 2006, 37 percent of GDP. That year the Federal government had a deficit of $248 billion. In 2007, the deficit was estimated to be $258 billion. While these are staggering amounts, financial markets have given US Treasury borrowing the best rates available. The reason for the good rates seems to be confidence in the US economy and the security that the US will redeem the debt.

FISCAL DISCIPLINE IN THE US

The structure of the US budget system was defined to a significant extent by the Constitution and its creation of a government with strict separation of powers. Since the constitution was ratified the budget system has been refined through a long history of innovation, periodically documented through additional changes in law. I would now like to briefly summarize the major changes.

Constitution: Section 9 of Article I of the Constitution provides that “No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law”. Section 8 gives the Congress the power to levy taxes and to pay debts. These authorities were intended to give the “power of the purse” to the elected representatives of the people.

Anti-Deficiency Act: To insure that the “power of the purse” remained with the Congress, in 1870 the Congress passed a bill to make it illegal for any government employee to obligate spending in excess of amounts provided in law. The “Anti-Deficiency Act” provided that no government agency may make expenditures during a fiscal year greater than provided by the law. It is this authority that OMB uses in execution of the budget. Agencies are required to apportion their appropriations by time or purpose to insure that they do not exceed the appropriated amounts. Violations of this law can lead to penalties ranging from minor disciplinary actions, loss of employment, fines or up to 2 years of imprisonment. Over half of the violations of the Anti-Deficiency Act occur in the Defense Department, due to the complexity of its finances rather than malfeasance. Most penalties involve reprimands, some reassignments of personnel or removal of personal. Few individuals have been criminally prosecuted.

Budget and Accounting Act of 1921

For the first one hundred and thirty years of the US history, there was no President's budget. All spending was discretionary and balanced budgets were the norm, except in time of wars and recessions. Congressional committees dealt directly with government agencies. The lack of a central focus for budgetary actions led to a fragmented action and no coherent strategy. In 1921, the Congress passed a bill requiring the President to transmit a budget for the entire government. The bill created the Bureau of the Budget in the Treasury Department, the predecessor to the current Office of Management and Budget. (OMB was moved to the newly created Executive Office of the President in 1939.) It also created the General Accounting Office, an investigatory agency of the Congress.

President's Commission on Budget Concepts

In 1967, President Johnson brought together a Commission to study the US budget system. The Commission's most significant recommendation was that the budget of the United States should be comprehensive of all Federal government activities, including self-financed programs like Social Security.

Congressional Budget and Impoundment Control Act of 1974

After 1921 the balance of power between the Congress and the Executive shifted toward the President. The Congress considered the budget in separate actions on spending and tax bills, but did not take any action of the budget as a whole. President Nixon challenged Congress, by refusing to carry out laws providing for spending for programs he did not support. This refusal to spend was labeled as an “impoundment”. These two factors led in 1974 to passage of the Congressional Budget and Impoundment Control Act. This act:

- established procedures for promptly considering Presidential impoundments
- created House and Senate Committees on the Budget,
- established a requirement for concurrent resolution on the budget to set budget aggregates,
- created the Congressional Budget Office, and
- subjected spending more or cutting taxes to a legislative point-of-order.

Top-Down Controls – Fiscal Rules 1985 – 2002

The US budget system was modified by four separate legislative actions during the last several years of the twentieth century in attempts to bring unsustainable deficits under control.

◗ Gramm-Rudman-Hollings: In the mid-1980s the US was faced by projections of two hundred billion dollar deficits as far as the eye could see. In 1985, the Congress passed the Gramm-Rudman-Hollings Act (GRH), a deficit based fiscal rule. This legislation established absolute deficit targets, requiring annual reductions to produce a balanced budget in 5 years. The bill provided a $10 billion cushion, but beyond that amount subjected all spending to across-the-board cuts, a “Sequester”.

◗ Other than the $10 billion cushion, GRH made no provision for the effect of the economy on the budget. Its across-the-board cuts would punish the innocent, those who had taken difficult political actions to reduce the budget, as well as those who hadn't.

◗ Within two years it was clear that the Congress could not reach the deficit target with politically acceptable cuts in government programs. GRH was amended to establish new less demanding targets.

◗ The original GRH required CBO and OMB to jointly determine whether the ceilings had been exceeded. The two agency's estimates were averaged. The US Supreme Court determined that the determination of excess was an executive function that must be done by the Executive Branch of government. In 1987, CBO was removed from GRH enforcement.

Budget Enforcement Act

In 1990, the US adopted an alternative approach, an expenditure rule. After a protracted negotiation between the Legislative and Executive Branch budgeteers, the Budget Enforcement Act of 1990 (BEA) was enacted.

The BEA was designed to limit legislative action on the budget. It set limits or caps on "discretionary" budget authority and outlays, and established a pay-as-you-go (PAYGO) requirement for entitlement spending and revenues. Under PAYGO, an increase in entitlement spending or cut in taxes would have to be offset by a reduction in spending elsewhere or an increase in taxes. It was enforced by sequesters that applied only to the offending Congressional Committee. Lower-than-anticipated economic growth, poor technical estimates, or emergencies could not trigger a sequester.

The BEA was extended in 1993 and again in 1998. The discretionary limits established by the BEA expired in 2002. Since that time, the discretionary levels proposed in the President's Budget, have functioned as de facto caps.

Current Outlook

From 1998 through 2001, the US budget was in surplus, reducing the incentive for politicians to agree to continuing fiscal constraint. The combination of the terrorist attacks of 2001, a downturn in the economy, and the wars in Afghanistan and Iraq, pushed the US budget into deficit. The budgetary goals of President Bush were to cut taxes and to hold non-security spending flat. The Democrats in Congress wanted higher discretionary spending and the end of tax cuts. These differences in budget policy have prevented agreement on new fiscal rules. Political differences also prevented any agreement on solutions to long-term budget problems resulting from the aging population.

Since the BEA expired, the only constraint to US deficits has been the lack of political agreement between the President and the democrats in Congress. Neither the President nor the Congress have had enough votes to be able to enact their budget policies.

The democratically controlled Congress has agreed to a budget resolution for 2008 that would increase discretionary spending. They have also agreed to impose a PAYGO constraint on legislation. This PAYGO constraint will make it difficult for the President to extend tax cuts that expire in 2010.

Lessons Learned From US Experience with Fiscal Rules: The deficit based rule, GRH did not work in the US. It didn't work because it did not allow adjustments for changes in the economy. The expenditure rule, BEA, did work, until four years of surpluses undermined the political support for fiscal constraint.

Based on US experience, I would suggest the following parameters to fiscal rules:

- Legislated fiscal rules have greater force
- Reaching consensus on legislated rules forces political consensus
- Fiscal rules need simple comprehensive enforcement
- Fiscal rules can not substitute for political will.

US BUDGET IS TRANSPARENT

Two strong agencies: OMB for the Executive Branch and CBO for the Congress provide the US government, the Congress and the public with a substantial array of budget information fostering an informed debate on budgetary issues in the United States. The President's Budget and agency justification materials provide the Congress in depth information many perspectives of the US public finance. CBO produces substantial quantity and excellent quality reports, letters, and testimony on the budget. Additional information on the budget is available through the press, over the internet and from interest groups.

Office of Management and Budget

The Bureau of the Budget was established by the Budget and Accounting Act of 1921 to produce a comprehensive budget for the US. Originally established as part of the US Treasury, it was moved to the Executive Office of the President in 1939. BOB's name was changed in 1970, to recognize its broad government management functions. The majority of OMB's staff are career civil servants (470 of about 500), a permanent staff charged with supporting the Presidency. Approximately 30 OMB staff members are politically appointed by the current President. The OMB Director is a member of the President's cabinet and the inner circle of White House staff members.

Congressional Budget Office (CBO)

The Congressional Budget Office was created by the Congressional Budget Act of 1974 to provide the Budget and Appropriations Committees of the Congress with expertise to balance the Executive Branch's Office of Management and Budget. CBO has a staff of about 230 budget experts, virtually all of whom are non-partisan. The Director and Deputy Director are selected alternatingly by the Budget Committees of the House and the Senate.

CBO is the scorekeeper for the Congress

It develops an annual economic forecast, updated in mid-year. It formulates a budget "baseline" – policy neutral budget estimate -- against which it measures the cost of all legislation. It reviews the President's Budget and undertakes periodic analyses of budget issues, such as budget options for long-term health care.

Economic Assumptions

The Executive Branch has an informal group named the "Troika" which prepares its economic assumptions. The Troika consists of the Director of OMB, the Secretary of the Treasury and the Chairman of the President's Council of Economic Advisors. CBO economic assumptions are reviewed by a Panel of Economic Advisors including six former CBO Directors and 14 eminent economists from a broad spectrum of economic thought. CBO's economic assumptions tend to be a consensus forecast, in contrast with the Executive Branch's forecast, which reflects the optimistic bias that the Administration's program will have positive economic effects. Both CBO and OMB's assumptions tend to be close to each other. Their reports frequently contain tables showing comparisons between their assumptions.

Role of the Federal Reserve

The central bank of the United States, the Federal Reserve has no formal role in the US budget process. The Federal Reserve is an independent body and guards its independence carefully.

Traditionally the Fed Chairman has on-going informal relationships with the Secretary of the Treasury, the Chairman of the President's Council of Economic Advisors, and the Budget

Director. The chairman is consulted informally on his views on the economy prior to the Administration adopting its economic assumptions. Shortly prior to the release of the budget, the Budget Director provides the Chairman a briefing on its major policies. When the Chairman testifies before Congress, it is not uncommon for him to address fiscal policy issues such as the need to cut deficits or reform entitlement programs.

Role of Medium Term Economic Framework

The US government has used multi-year estimates for several budgetary purposes in the past. The top-down budget controls established in the 1980s and 1990s were written for five year periods. There is a current legal requirement for two year appropriations for the Defense Department. Not withstanding this requirement, the Congress has not enacted a two year appropriation. Government reformers continue to push bi-annual budgeting, without success.

Almost all tables in the US budget include estimates for the budget year, the current year and the prior year. The primary focus of the budget formulation process and appropriations action by the Congress is for one year. Detailed language is limited to one year, currently 2008.

The Budget includes annual estimates for the budget year, plus four years and ten year totals for policy proposals affecting mandatory spending or revenues. These longer term estimates are provided because many of the policies take years to implement and the full cost is not known for several years.

Capital investment programs such as defense procurement, Energy research, and the National Aviation and Space Administration are planned for the life of the project. The budget includes five-year estimates of these costs.

The budget also includes long-range estimates for major entitlement programs. Seventy-five year estimates and infinite horizon estimates are provided for Social Security and Medicare and other retirement programs to capture the actuarial impact of program changes.

CBO's Budget and Economic Outlook, Budget Options, Analytical studies and cost estimates all include annual estimates for five years, and ten year estimates. Long-term estimates are also presented for policy changes that have significant out-year affects.

The baseline

A current services or policy neutral baseline is used as a benchmark to measure the costs of policy proposals, both in presentations in the Budget and in CBO's analyses. OMB develops a current services baseline for the President's budget which is included in the Analytical Perspectives volume of the Budget. CBO prepares a comparable estimate that they use as a benchmark for cost estimates for pending legislation.

These estimates are developed using current law and current economic forecasts. Discretionary programs are adjusted for inflation. Some critics of baseline estimates assert that a nominal freeze is a more appropriate benchmark for discretionary programs. Others argue that discretionary programs should be adjusted for inflation and demographic changes.

Mandatory programs and revenues estimates reflect both demographic changes and economic assumptions.

The Budget Act excludes emergencies from the baseline, although some emergency needs will continue in the future. Funding for response to natural disasters does occur every year. Only the severity of the disaster and the level of Federal response are unknown. The costs of the war in Iraq have been excluded from budget controls by defining them to be emergency costs.

Budget Documents

The US Budget provides a large volume of information. The President's Budget transmitted each February consists of four books, approximately 2,000 pages. It consists of:

- The Budget of the United States – a 200 page policy summary of the Budget introduced by a statement by the President,
- Analytical Perspectives – a compilation of special analyses on budgetary topics, for example a chapter on credit programs, another on capital investment, and another on the borrowing and debt,
- Budget Appendix – proposed appropriations language, financial tables, and explanatory materials for each of the 1,200 budget accounts,
- Historical Tables – tables presenting various perspectives of the budget, some back to 1789. Most tables begin in the 1940s.

In addition to the Budget books, the budget is available on-line and a detailed database supporting the budget is available. The on-line data includes the detailed performance and results assessments of each Federal program.

Agencies produce detailed justification materials for the Congress to support the President's budget. For example, the Department of the Interior provides the Appropriations Committees nine volumes, each about 400 pages, of supporting materials for its budget request.

Major CBO Reports

CBO provides the Congress and the public an independent source of information on the budget. From its inception, CBO has placed great emphasis on the quality of the writing and the estimates in its reports. All of its reports are available on the internet.

Table 1

MAJOR CBO REPORTS

Budget and Economic Outlook	Prepared annually at the beginning of the legislative session, provides ten year estimates, comparisons to Administration and private sector forecasts
Budget Options	Report contains a range of policy proposals to reduce spending or increase revenues – no recommendations.
Long-term Budget Outlook	Spending and revenue implications of alternative economic scenarios for 75 or 100 years – on the aging baby boom population.
Analysis of President's Budget	CBO estimates the budgetary impact of the President's Budget using CBO's economic assumptions and budget baseline
Monthly Budget Reports	Analyses of Federal spending and revenues for the previous month based on Treasury reports of actual fiscal data for the month and CBO forecast of annual budget flows (one each month)
Analytical Studies	At the request of Congressional Committees, CBO analyzes budget implications of specific policy choices: e.g. Projections of Net Migration to the US or The Effects of Liberalizing World Agricultural Trade (39 reports in 2006)

Cost Estimates

The President's budget includes estimates of the costs of all of the President's proposals. CBO provides re-estimates of the President's proposals and provides estimates of the costs of every bill reported by the Congress. Its cost estimates include the five and ten year spending effects of the bill, an explanation of the basis of the estimate, and where appropriate, assessments of the intergovernmental or private sector mandates included in the bill. CBO also provides informal estimates at earlier stages in the legislative process, and may work with the Committee to propose changes in language to produce different budget effects. In 2006, CBO prepared over 600 formal cost estimates and approximately 1,000 estimates of unfunded mandates on States and local governments.

Relationship between OMB and CBO

OMB and CBO have a close working relationship. There are a significant number of staff members of each organization who have worked at the other organization. I worked at CBO for its first eleven years and at OMB for twenty two years. My predecessor at OMB left for CBO and my replacement at OMB had been CBO's Deputy Director. Moreover US legislation says that nobody shall hinder the free communication between the staff of the legislative and the executive.

Under the original GRH deficit control procedures, the average of OMB and CBO estimates were used to determine if the deficit ceilings were exceeded. OMB and CBO worked jointly with the staff of the Congressional budget committees to establish scoring rules to govern enforcement under both GRH and the BEA. The goal of these rules was to ensure that both score keeping agencies used the same scoring concepts to focus debate on differences in policy, rather than scoring differences.

The leaders of OMB and CBO work together to minimize differences between the agencies' estimates. Budget analysts from each agency also regularly work with their counterparts to ensure that they share common understandings of the budget implications of proposals. This close cooperation is intended to avoid differences based on interpretation while maintaining the independence of each agency's estimates.

Transparency Issues for the US: The US Budget is transparent thanks to the efforts of OMB and CBO and the volume of information provided to decision makers and the public. There are, however, several reasons for concern:

First, the US Budget is extremely complex. Complexity trumps transparency. Detail and volume of information are not sufficient to provide transparent budget information, if the average member of Congress or the public does not understand. The basic budget presentations may be too complex to be readily understood. Further effort should be given to simplifying budget information.

Providing inadequate information on performance of government programs reduces the transparency of public expenditure in the US.

Both OMB and CBO provide substantial budget information over the internet, but neither internet resource is user friendly. The information provided are copies of published documents and access to data bases, not information designed for the internet user. The budget in brief should be developed for the internet audience.

CONCLUSION

Good governance requires sound fiscal policy and an open budget process. The US experience may not be directly relevant to Hungary, but hopefully our successes and failures may provide insights that will be useful to you.