CBO PAPERS

MANDATORY SPENDING CONTROL MECHANISMS

February 1996

CONGRESSIONAL BUDGET OFFICE

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PREFACE

This Congressional Budget Office (CBO) paper analyzes methods of controlling mandatory spending through the budget process. It catalogs both the methods that are now in place and mechanisms that have been proposed in recent years. In the case of the proposed mechanisms, it also examines how well they might perform according to certain criteria. The paper was prepared in response to a request from the Subcommittee on Legislative and Budget Process of the House Committee on Rules.

Neal Masia of CBO's Special Studies Division wrote the paper under the direction of Robert Hartman and Marvin Phaup. James Blum, Gail Del Balzo, James Horney, Philip Joyce, Richard Kasten, Constance Rhind, and David Torregrosa offered helpful suggestions. Jeffrey Holland provided the data for Table 1. Leah Mazade edited the paper, and Christian Spoor proofread it. L. Rae Roy prepared the report for publication.

June E. O'Neill
Director

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CONTENTS

TABLES

SUMMARY AND INTRODUCTION

The Congress has often enacted laws that entitle people, states, or other entities fulfilling certain eligibility requirements to receive payments or benefits from the federal government. (An example of such legislation is the Social Security Act of 1935, which authorized the Social Security program and was later amended to authorize the Medicare program.) In addition, other laws that do not technically establish entitlements nevertheless obligate the federal government to make specified mandatory payments. Spending of that nature is often referred to as mandatory spending because the law requires that the funds be made available. (Entitlements are a subset of mandatory spending.) In some cases, such as Social Security, payments take place without an annual appropriation; in other cases, such as Medicaid, the Congress by law must pass an appropriation bill. Spending that is not mandatory, such as spending for defense or for the Commerce Department, is usually called discretionary. The law does not require that funds for such programs be made available annually; however, most discretionary spending is provided for in 13 regular annual appropriation bills.

Over the past two decades, mandatory spending has been growing rapidly, both as an absolute amount and as a percentage of total spending. Federal spending for mandatory programs now accounts for about 12 percent of gross domestic product and over 54 percent of federal budget outlays. In recent years, policymakers have struggled to control such expenditures, but most observers believe that those efforts have fallen short. Although the Congress made (or proposed) significant cuts in mandatory programs in 1995 (as it did in the Omnibus Budget Reconciliation Acts of 1990 and 1993), the likelihood of continued high rates of growth has left many Members feeling frustrated. Therefore, legislators have also been considering changes in the way mandatory spending bills are considered in the legislative and budget processes.

Observers frequently note that it is difficult to link changes in the budget process with particular policy outcomes--the failure of the Balanced Budget and Emergency Deficit Control Act of 1985 (also known as Gramm-Rudman-Hollings) supports that observation. The budget process is much better at enforcing compliance with explicit changes in policy, as it has done under the Budget Enforcement Act of 1990, than at producing changes through indirect means. The attempt now under way to enact policies that would result in a balanced budget in seven years is an example of the former case, in which changes in policy precede changes in process. In fact, if the Congress implements the policies that it is now considering, the short-term search for mechanisms to control mandatory spending might end because the programs driving the large increases in that spending--Medicare and Medicaid--would exhibit lower rates of growth.

Yet in the light of past failures, many Members are concerned about the credibility, over the long term, of plans to balance the budget. As a result, they seek alternatives to ensure that spending will not increase in the future. Supporters of changes in the budget process contend that those changes can at least point policymakers in the direction of reducing spending and can help to frame politically sensitive issues in a way that might allow those issues to be considered in that context. Furthermore, proponents point out that well-designed process changes can introduce credible penalties for failing to act, which might encourage substantive legislative changes.

The Congress has several methods of controlling mandatory spending. Clearly, the most direct way is simply to change each underlying law that specifies who is to receive benefits and in what amounts. It is, however, politically burdensome to vote to cut previously enacted levels of spending. (In the extreme case, some mandatory programs--such as Social Security--cannot even be discussed without provoking controversy.) Tools now in place for controlling spending recognize that difficulty: for example, large deficit reduction packages (also known as reconciliation bills) combine cuts in spending with other measures, requiring legislators to vote the entire package up or down; and the pay-as-you-go process raises the prospect of an across-the-board sequestration (that is, a cancellation of budgetary resources) if new spending is not offset by tax increases or spending reductions.

The current Congress has tried to control spending directly by converting some mandatory programs into block grants to the states or by embedding fail-safe provisions in spending legislation. (Fail-safe provisions specify actions that shall occur in the event of unexpected increases in spending.) Because, however, the Congress has not controlled mandatory spending using the tools that are now available, reformers have proposed new methods of control with certain goals in mind. Among them are to ensure the desired result (for example, lower spending); to apply the cuts flexibly, when needed; to maintain accountability as a characteristic of the mechanism; and to keep the approach relatively simple. All proposals may be evaluated on their ability to meet those goals; in addition, other aspects must be considered (such as the mechanisms' potential effects on the social safety net).

Proposals under consideration in recent years include ending the mandatory status of all such programs, creating explicit caps on mandatory spending that are analogous to the caps on discretionary spending that are already in place, introducing targets for overall deficit reduction but with optional enforcement, and controlling spending by program area using automatic reductions when necessary. Most of the plans achieve some of the reformers' goals but not all of them. Some plans seem likely to control spending at the cost of reduced flexibility, whereas others are so flexible that nothing is assured. Some approaches look good in theory but would be so complicated that they could probably never be implemented; others are quite

simple but would take away part of the social safety net. Some systems would ensure cuts in spending by threatening to sequester funds from all programs regardless of whether spending in only some of those programs was too high, whereas others plan to penalize only the programs with funding shortfalls--which increases accountability in theory but raises doubts about execution. This paper catalogs the methods for controlling mandatory spending that are now in place and discusses recent proposals for new ones. It also analyzes how those mechanisms might be assessed.

MANDATORY SPENDING: HOW MUCH WILL IT GROW, AND WHY IS IT MANDATORY?

As noted earlier, mandatory spending, in both absolute dollar terms and as a percentage of total government spending, has been growing for years and is projected to continue to grow under current policies (see Table 1).[1] In dollar terms, total mandatory spending is projected to increase from $881 billion to $1.6 trillion over the 1996-2005 period; as a percentage of all federal spending, it is projected to grow from just over 55 percent in 1996 to about 64 percent in 2005. After debt service and offsetting receipts are taken into account, it becomes clear that the remainder of all federal spending--that is, discretionary spending--constitutes only a small (and, over the years, increasingly smaller) proportion of the total budget.

The Congressional Budget Office (CBO) distinguishes between means-tested programs (which provide cash, benefits that are equivalent to cash, or services to people who meet a test of need based on income, assets, or other criteria) and non-means-tested programs (which do not base eligibility on such a test). In 1996, non-means-tested programs make up over 77 percent of all mandatory spending; the two largest non-means-tested programs, Medicare and Social Security, represent nearly 62 percent of total mandatory spending. Medicaid, which requires recipients to satisfy a means test, is the third-largest mandatory program and accounts for more than 11 percent of all mandatory spending. By 2005, CBO projects that non-means-tested programs will decrease to about 74 percent of mandatory spending. Social Security and Medicare together are projected to remain at about 62 percent of mandatory spending, but Medicaid is projected to grow to over 14 percent.

Another useful way to view the growth of mandatory spending programs is to consider the rates of growth projected for their overall spending (see Table 2). From that perspective, Medicare and Medicaid are not only two of the largest programs, but they are also two of the programs that are projected to grow the fastest over the

1. Debt service and offsetting receipts are not included in this discussion. Legislation may affect offsetting receipts directly, but it affects debt service only indirectly.

TABLE 1. CBO BASELINE PROJECTIONS FOR MANDATORY SPENDING
(By fiscal year, in billions of dollars)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
				Means-Tested Programs						
Medicaid	97	107	118	130	142	157	173	190	209	229
Food Stamps[a]	26	28	29	31	32	33	35	36	38	40
Supplemental Security Income	24	29	32	35	41	37	44	47	51	59
Family Support	18	18	19	19	20	20	21	22	23	23
Veterans' Pensions	3	3	3	3	3	3	3	3	3	3
Child Nutrition	8	8	9	10	10	11	11	12	12	13
Earned Income Credit	19	20	21	22	23	24	25	25	26	27
Student Loans[b]	2	2	2	2	3	3	3	3	3	3
Other	4	4	5	5	5	6	6	7	7	8
Total, Means-Tested Programs	201	220	238	256	279	294	32	345	371	405
				Non-Means-Tested Programs						
Social Security	349	367	386	405	425	447	469	493	518	545
Medicare	196	216	236	258	281	305	332	362	396	435
Subtotal	546	583	622	663	706	752	801	855	915	981
Other Retirement and Disability										
Federal civilian[c]	44	46	49	51	54	57	59	62	65	68
Military	28	29	31	33	34	35	37	38	40	41
Other	4	4	4	4	5	5	5	5	5	5
Subtotal	76	80	84	89	93	97	101	105	109	114
Unemployment Compensation	24	25	26	27	28	29	31	32	33	34
Other Programs										
Veterans' benefits[d]	17	19	19	20	22	23	23	24	25	26
Social services	6	6	6	6	6	6	6	6	6	6
Credit reform liquidating accounts	-4	-6	-7	-6	-6	-6	-6	-6	-6	-7
Other	15	18	19	21	20	21	21	20	20	20
Subtotal	34	36	37	40	41	44	44	44	45	46
Total, Non-Means-Tested Programs	680	724	769	819	868	922	977	1,036	1,102	1,175
				Total Mandatory Spending						
In Billions of Dollars	881	945	1,007	1,075	1,147	1,215	1,297	1,380	1,473	1,580
As a Percentage of Federal Spending	55.2	56.7	58.0	59.1	60.1	61.0	61.8	62.5	63.2	64.1
As a Percentage of GDP	12.0	12.3	12.5	12.7	12.9	13.0	13.2	13.4	13.7	13.9

SOURCE: Congressional Budget Office.

NOTES: Spending for major benefit programs shown in this table includes benefits only. Outlays for administrative costs of most benefit programs are classified as domestic discretionary spending; Medicare premium collections are classified as offsetting receipts.

Numbers may not add to totals because of rounding. GDP = gross domestic product.

a. Includes nutrition assistance to Puerto Rico.
b. Includes both direct and guaranteed loans.
c. Includes Civil Service, Foreign Service, Coast Guard, and other retirement programs, and annuitants' health benefits.
d. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.

TABLE 2. CBO BASELINE PROJECTIONS FOR THE PERCENTAGE INCREASE IN GROWTH RATES OF TOTAL SPENDING FOR MANDATORY PROGRAMS

Program	1996-2000	1995-2005
Supplemental Security Income	71	146
Medicaid	46	136
Medicare	43	122
Child Nutrition	25	63
Social Security	22	56
Federal Civilian Retirement[a]	23	55
Food Stamps[b]	23	54
Veterans' Benefits[c]	29	53
Student Loans[d]	50	50
Military Retirement	21	46
Earned Income Credit	21	42
Family Support	11	28
Veterans' Pensions	0	0
Social Services	0	0

SOURCE: Congressional Budget Office.

a. Includes Civil Service, Foreign Service, Coast Guard, and other retirement programs, and annuitants' health benefits.
b. Includes nutrition assistance to Puerto Rico.
c. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.
d. Includes both direct and guaranteed loans.

next five to 10 years. Social Security is expected to grow moderately over the next 10 years, but that growth will accelerate after the 10-year window, when the baby boomers begin to retire. Welfare programs other than Medicaid constitute a relatively small share of the budget and, with the exception of Supplemental Security Income, are not projected to grow very fast.[2]

Several explanations can be put forward for why Social Security, Medicare, and Medicaid make up such a large percentage of present and future total mandatory spending. One is the scope of the programs: most legal residents over age 65 are eligible to receive benefits under Social Security and Medicare, regardless of their level of income. Demographic shifts, such as increased life expectancies, have also contributed to continued and projected growth. Other reasons for high levels of spending and projected rates of growth in Medicare are increased health care consumption by the eligible population and inflation in the medical care industry, which is high relative to overall increases in prices. Moreover, benefits under Social

2. Total spending for the Supplemental Security Income programs is still projected to be much lower than spending for Medicare or Social Security.

Security and other retirement programs depend not only on inflation and demographic changes but on real wages (that is, wages adjusted for inflation)--the increase in real wages that analysts expect in future years implies higher levels of benefits in the future.

Policymakers have aimed their recent budget-cutting efforts at Medicare and Medicaid in particular, because they are such big targets. In the case of Medicare, a perceived threat of insolvency in the system has fueled those activities. In contrast, Social Security has been placed "off the table" in current budget negotiations. Other attempts to control mandatory spending have focused on welfare, which usually denotes means-tested programs. For example, some lawmakers have advocated repealing those programs in favor of block grants to states (see the later discussion).[3] The choice of a specific control method will depend in part on what role legislators envision for mandatory programs. It therefore seems worthwhile to examine the reasoning behind the existence of mandatory programs as well as the problems critics contend those programs cause.

What Are the Advantages of Mandatory Spending Programs?

Mandatory spending programs provide benefits to a broad range of people. Although each individual entitlement or mandatory program has been designed to achieve a particular set of goals, it is possible to distinguish broadly between two main purposes of many of the programs: acting as a social "safety net" and enhancing people's ability to plan for the longer term. (That categorization is not exhaustive, but most mandatory programs are intended to serve at least one of those purposes and some serve both.) The distinction is useful because attempts to control mandatory spending through the budget process might have different effects on the ability of such programs to serve the broad purposes for which they were intended.

Social Safety Net. Many taxpayers and policymakers believe that society should ensure a minimum standard of living for the U.S. population. In this century, government has come to play a large role in providing that minimum level of subsistence. According to proponents of spending for mandatory programs, that function becomes especially important when the U.S. standard of living is threatened by economic downturns or other unavoidable events. Advocates argue that programs such as Medicaid, Aid to Families with Dependent Children (AFDC), and Food Stamps are a social safety net, providing some people with subsistence and the means to cope with medical or financial emergencies. In hard economic times, mandatory

3. Other CBO publications, such as the annual deficit reduction volume, present options for cutting spending through particular programmatic changes such as changing the retirement age, reducing or eliminating cost-of-living adjustments, means-testing more programs, or establishing work requirements for welfare recipients.

spending programs can act as automatic stabilizers, arresting declines in income that might otherwise plunge families and individuals into extreme poverty.

Longer-Term Planning. Some mandatory programs, most notably Medicare and Social Security, provide benefits to recipients regardless of their current income.[4] Medicare and Social Security are two of the federal government's most staunchly defended programs; indeed, Social Security is usually excluded from discussions about controlling mandatory spending and is afforded special treatment in the budget. The broad support for these programs probably stems in part from the fact that people who do not currently receive benefits will eventually be entitled to them. Aside from the redistributional component of the programs, many taxpayers view them as part of their personal insurance and retirement plans. Proponents argue that it is in that sense that mandatory programs serve their second main purpose: as an aid or supplement to midrange and long-term financial planning. Even if the programs were originally intended only as a safety net, people now view their benefits as personal assets that they expect to receive in the future. In some cases, it is the only form of insurance in which they participate.

Many observers claim that programs such as Social Security and Medicare benefit society as well as individuals by improving the long-term manageability of retirement planning. With a well-planned retirement, many taxpayers can avoid using the short-term safety net as a long-term solution when their wage-earning days are behind them. Thus, proponents maintain that the programs provide not only personal but social insurance: they reduce the likelihood of beneficiaries' becoming a burden on society by forcing future recipients to contribute to social insurance while they are working.

What Are the Objections to Mandatory Spending?

Mandatory spending programs have critics as well as supporters. Some of those opponents worry that the structure of the programs leads to inevitably high rates of growth. Others contend that many of the programs offer the wrong incentives to recipients or ensure that the government plays an unacceptably large role in the lives of taxpayers.

Rapid Spending Growth. The fundamental objection that most critics have to the current system of mandatory spending is that there is no explicit budget constraint on most of the programs. Instead, spending rises or falls according to economic

4. To the extent that the benefits are subject to taxation (as is the case with some Social Security benefits and most federal employee pensions), the value of after-tax benefits can depend on a recipient's current income; however, eligibility for benefits does not.

fluctuations, program participation rates, the behavior of individual states, and demographic shifts. Furthermore, spending for two of the largest programs, Medicare and Medicaid, depends on increases in the price of medical care, which have recently been quite large and are fueled by advances in medical technology and the behavior of medical care providers.

Without changes in the laws governing mandatory programs, the high rates of spending for them will probably continue indefinitely. Many policymakers worry about the open-endedness that statement implies, which is one reason they have been looking for ways to set limits on spending. The Congress has also been considering wholesale changes to the programs themselves--for example, one proposal that has received much attention is to transform some welfare programs (in particular, Medicaid) into block grants to individual states. The idea behind that approach is to limit federal funds for the programs and let the states grapple with unexpected increases in prices, with utilization rates for some kinds of care that are higher than anticipated, and with other such changes.

Incentive Problems. Criticisms of mandatory spending programs are usually couched in terms of improvements to their incentive structure or their overall scope. Some critics contend that the programs themselves may provide incentives that encourage the type of behavior that created a need for the programs in the first place. Those critics rarely support abolishing all social safety net programs; rather, their objections relate to which contingencies the government ought to address.

A related problem that some people have with government insurance programs is the way they affect beneficiaries' planning. Although a social safety net is intended to fill gaps in income that might arise from events that are beyond a person's control, mandatory spending programs create incentives for future recipients to intentionally plan for gaps (that they know will be filled by government benefits) over the middle and long terms. For example, the amount of money many workers save for retirement depends on their expectations about future benefits, and the amount of health insurance they purchase in later years depends on what they think they will receive in Medicare benefits.

The Proper Role of Government. Some programs that are intended to help people plan for the long term provide assistance to recipients who would not be excessively burdened by the loss of some (or even in some cases, all) of their benefits. Some people take issue with the government's large role in income redistribution in this country and question why the government transfers wealth (in the form of benefits) to recipients who do not need it. Such critics usually point to open-ended mandatory programs as an example of the government's overstepping its appropriate role in the lives of residents. One approach that has been frequently proposed to resolve this

issue is to means-test a wide range of benefits, thereby reducing the overall scope of government payments and activities.

MECHANISMS NOW IN PLACE FOR CONTROLLING MANDATORY SPENDING

The Congress currently has several ways it can limit mandatory spending; the most important are the rules for budget resolutions and reconciliation established by the Congressional Budget and Impoundment Control Act of 1974 and the pay-as-you-go (PAYGO) process set up in the Budget Enforcement Act of 1990. In addition, some people believe that certain methods of treating mandatory spending legislation can act as controls. Two examples are block grants and fail-safe provisions.

Reconciliation

Reconciliation was included as part of the 1974 act, but it was not used in its current broad form until the early 1980s. In the reconciliation process, the Congress considers a number of changes in mandatory spending programs and revenues at one time, in large omnibus measures. The committees responsible for the spending programs are directed by the Congress's concurrent resolution on the budget to recommend changes to the law that will result in a certain amount of projected spending or revenue. The process is optional, but it has been used with increased frequency in recent years. Usually, the group of reforms is presented as a deficit reduction measure and is voted on under restrictive rules in both Houses of Congress. Packaging the reforms into an omnibus proposal is crucial: although cuts to individual programs might be defeated on a case-by-case basis, considering them together (in an up-or-down vote) increases the chances of their being passed. (Legislators can correctly claim that they have voted for deficit reduction, thus mitigating the political cost of their vote by appealing to a sense of shared sacrifice.)

PAYGO Rules and Sequestration

The Balanced Budget and Emergency Deficit Control Act of 1985 (the Balanced Budget Act) introduced the idea of sequestration into the budget process. The Balanced Budget Act established deficit targets for each year through 1991. If the Congress did not meet one of the targets, a sequestration would be triggered; that is, across-the-board reductions would be made automatically in both mandatory and discretionary spending. The idea behind the mechanism was that the Congress would ensure that the deficit reduction targets were met to avoid the unpleasant alternative of across-the-board reductions in programs. Some programs were protected from the

sequestration; in particular, many mandatory programs were either excluded from cuts or the cuts were severely limited. As a result, discretionary programs were exposed to potentially large-scale reductions. By 1990, however, the targets had been rendered meaningless, and in 1993 they were not extended. The failure of the Balanced Budget Act to control spending and reduce the deficit led to the consideration of alternative mechanisms.

The Congress carried over the basic idea of sequestration as an enforcement mechanism to its next reform, the Budget Enforcement Act of 1990 (BEA). The act eliminated fixed deficit reduction targets as a restraint and instead set out pay-as-you-go rules for the budget process. The new rules basically required that the projected net effect of all mandatory spending and revenue legislation enacted in a fiscal year be deficit neutral within that year and for five subsequent fiscal years; that requirement was (and still is) enforced by a sequestration mechanism. CBO and the Office of Management and Budget keep track of all new direct spending and revenue legislation on a scorecard, and if the scorecard shows a projected net addition to the deficit at the end of the budget cycle, a sequestration eliminates the increased spending. In concentrating only on the effects of new legislation, the BEA has a much narrower focus than the Balanced Budget Act. Some people cite that difference as the reason for the relative success of the BEA.

The two types of sequestration mechanisms differ in several ways. First, under the BEA, the amount to be sequestered is limited to the amount that is added to the deficit on the PAYGO scorecard--rather than some predetermined overall deficit reduction target such as those found in the Balanced Budget Act. Second, under the BEA but not under the Balanced Budget Act, increases in mandatory spending programs under current law cannot trigger a PAYGO sequestration, although those programs would still be cut if a sequestration was triggered by new legislation. Third, and perhaps most important, PAYGO rules hold the Congress harmless for changes in economic conditions and other factors that affect the baseline (the benchmark for measuring the budgetary effects of proposed changes in federal revenues or spending). Unlike the Balanced Budget Act, the BEA requires only that new legislation be projected to be deficit neutral for each fiscal year. It guarantees neither a total maximum level of mandatory spending nor that the new legislation will actually be deficit neutral in the end. Rather, the PAYGO rules guarantee that projected spending and revenues under new legislation will add up to zero on a deficit scorecard or a sequestration will be triggered to cut spending. What the two mechanisms have in common is that they were both intended to provide incentives for the Congress to hold down spending increases and to enforce a particular decision about the level of spending control--whether that decision be to control only new legislation or the deficit overall.

Block Grants

The 104th Congress has been particularly interested in changing means-tested programs that are currently administered, in whole or in part, by the states. That group of mandatory spending programs, which includes Medicaid and AFDC, makes up a large part of what is commonly thought of as welfare. Today, most federal funding for those programs takes the form of matching grants to states, and the matching rate (the amount that the federal government contributes for each dollar the state contributes) depends inversely on per capita state income. States generally have some latitude in setting eligibility standards and benefit levels, subject to certain minimum program characteristics that are necessary to qualify for federal funds. Many (but not all) block-grant proposals would use the current levels of funding for each state as a baseline, and simply require that the level of federal funds to be spent by each state in future years be determined by adjusting the current level for inflation or other changes. Other block-grant proposals would go farther and eliminate the mandatory aspect of the spending, requiring that new funds be voted on and distributed to states on a regular basis. Most welfare programs would be repealed, leaving states with much broader latitude to determine how to distribute funds among their programs. Proponents believe this approach would effectively limit spending for mandatory programs; critics question the long-run viability of vesting states with greater responsibility for the programs.

Fail-Safe Mechanisms

Fail-safe provisions are included in legislation to specify contingency plans for particular programs in the event that spending is higher than originally anticipated. (The approach is a fallback provision that specifies precisely how, if necessary, spending is to be cut.) The detailed nature of many fail-safe mechanisms often contributes to the contentiousness surrounding consideration of what are generally complex bills, but proponents believe that their inclusion ensures that spending will be controlled. However, many policymakers doubt that the provisions would be faithfully executed if they were invoked to reduce spending.

RECENTLY PROPOSED CONTROL MECHANISMS

Detailed below are specific proposals for additional mechanisms to control mandatory spending that have been introduced as legislation in the 103rd and 104th Congresses. It is worth reiterating that all of those mechanisms are ways of changing either laws, benefit levels, or other program characteristics when the Congress does not make those changes directly in stand-alone legislation or when the changes that it does make are judged insufficient. Of course, the Congress may change the

specific substantive laws underlying mandatory programs at any time, which would eliminate the need for other (that is, procedural) reforms to control spending. In fact, one might state that the most obvious and direct mechanism for reducing mandatory spending is just to change the underlying laws directly. But because each such program sharply enhances the well-being of specific groups, the political realities faced by legislators often make cutbacks unpalatable, if not impossible.

Overall Cap with Automatic Enforcement

The mechanism proposed under this approach would focus on overall mandatory spending as its core concern. (Some examples of proposals are H.R. 2060, introduced by House Majority Leader Richard Armey in the 104th Congress; S. 149, introduced by Senator Phil Gramm, also in the 104th Congress; and H.R. 883, H.R. 4585, and S. 377, all introduced in the 103rd Congress.) The approach would require total spending to be at or below a particular level and would try to enforce that requirement through sequestration. (In its attempt to use sequestration for enforcement, the mechanism is a descendant of both the Balanced Budget Act and the PAYGO system.) Social Security is explicitly excluded from all consideration under this approach, although there is no technical reason why it could not be made subject to the provisions of the various bills.

The Armey bill is a useful representative to examine in greater detail. It would use the current year's spending for all mandatory programs, after adjusting for inflation and changes in the eligible population, as the baseline with which spending levels in future years would be compared. Overall spending above the level implied by the adjusted baseline in any year would trigger an across-the-board sequestration for all nonexempt programs. The bill contains very detailed provisions and limitations on how much, and in what general order, programs may be cut. Means-tested programs would be limited to cuts of 1 percent, federal retirement and veterans' benefits would be limited to cuts of 2 percent, and Medicare would be limited to 4 percent. The remaining nonexempt programs would be cut by a uniform percentage to make up the difference.[5] The bill also contains global spending limits (that would apply to discretionary spending as well) for a seven-year period. If those limits were exceeded, a second sequestration would take effect.

5. The bill's limitations on and exclusions of the biggest mandatory programs raise an interesting question: what would happen if there was not enough spending left in the remaining programs to carry out the entire sequestration?

Overall Spending Target with Optional Enforcement

The approach taken in H.R. 4064, which was introduced by Congressman John Spratt in the 103rd Congress, would be to codify an overall target for mandatory spending similar to that instituted by Executive Order 12857 after the Omnibus Budget Reconciliation Act of 1993. A useful way to look at the Spratt bill is as an extension of the reconciliation process; the approach is intended to make it more likely that reconciliation-style legislation will be enacted.

The bill calls for the Office of Management and Budget to project levels of overall mandatory spending under current law for several fiscal years. Those projections would be treated as targets. Each year, the President would have to include in the Administration's budget submission a review of mandatory spending that contained a comparison of the original targets and the most recent projections. The budget would also contain a special "direct spending message." (Direct spending is a synonym for mandatory spending.) That message would contain either detailed recommendations on how to reconcile the difference between the targets and the projections or a special resolution stating the reasons for not recommending any changes. The Administration's budget already includes such a message in order to comply with the executive order, but the Spratt proposal would handle it differently: the Congress would consider the direct spending message as either additional reconciliation directions to be included in the budget resolution or, if no resolution was passed, as a separate measure. In short, the Spratt approach would require the Congress to explicitly consider only mandatory spending above a previously established current-law baseline. The Congress could waive that requirement if it either raised the targets or set aside the point of order against considering budgets that contained spending above those targets. If overall mandatory spending was not above the total "target" baseline, no change would be required or recommended.

Caps on Spending Areas with Automatic Enforcement

Some proposals, including H.R. 1516, introduced by Congressman Peter Visclosky in the 104th Congress, focus on more narrow program areas as an alternative to across-the-board mandatory cuts. The Visclosky bill contains controls on both overall spending and spending by program area. The bill would establish targets for deficit reduction to be achieved through changes to mandatory spending and revenues over the next seven years. In some respects, this bill can be seen as a superstructure resting on the current PAYGO rules: it would establish a scorecard, analogous to the current PAYGO one but treating spending and revenue legislation separately and modifying the goal of deficit neutrality. Instead of neutrality, the scorecard would include--as an expenditure--the amount of mandated deficit reduction to be derived from mandatory spending in a given year, with new

legislation making up the difference. Another change from the PAYGO rules is that if a sequestration was triggered, it might involve automatic tax increases in addition to or instead of automatic spending cuts. The route taken would depend on whether the shortfall was due to legislation that lowered revenues or raised expenditures.

Another important point of divergence between the Visclosky plan and PAYGO is that the Visclosky bill creates an optional spin-off law that, if enacted, would change the potential sequestration from a general to a program-specific one. At any time, the Congress could create such a law, analogous to reconciliation instructions, that would prescribe changes in policy. Those changes would result in reductions in spending or increases in revenue, or both, that mandatory spending programs would be required to contribute toward deficit reduction in that year. The law would specify amounts of spending reductions or revenue increases that the respective committees would then propose. If a spin-off law was in place and the scorecard was out of balance, sequestrations would be triggered and applied specifically to the programs of committees that failed to produce the savings demanded in the law.

Eliminating Mandatory Status

Mandatory spending programs are often called uncontrollable because the amount to be spent each year in many cases is determined only by applying current law to a pool of beneficiaries. (Conversely, spending is usually called controllable if an explicit dollar amount is appropriated for each year.) Under current law, the amount to be spent on mandatory programs each year depends on several factors: the benefits established by law, the number of applicants (which in turn is determined in part by economic conditions and other uncontrollable circumstances such as natural disasters), and rules that may be established, interpreted, or changed by individual states, courts, and regulators. Some critics of mandatory spending argue that the open-ended approach to funding those programs is inappropriate. They support switching from open-ended funding to annual appropriations for all programs.[6]

H.R. 2929, introduced by Congressman Christopher Cox in the 103rd Congress, would eliminate open-ended mandatory spending by requiring that an explicit amount be appropriated each year for each program. In addition, heads of agencies that administer the programs would be given broad authority to make decisions about policy to ensure that funding did not run out during the fiscal year. The plan would cause a major shift in decisionmaking power from the authorizing committees to the

6. Many mandatory programs already receive annual appropriations (for example, AFDC and Medicaid). However, because they are entitlements, the amount of the appropriation is required by law, and thus they cannot be directly controlled.

appropriations committees--who would gain the authority to set spending limits--and from the Congress to the agencies. In theory, enforcing mandatory "caps" of that kind would be relatively easy: as with most appropriations, when the money to be obligated for a fiscal year ran out, no further commitments could be made.[7] Thus, whatever level of spending the Congress decided on during the budget process would theoretically be enforced without further action. In order for the approach to work, the legislation entitling eligible individuals to benefits would have to be repealed; otherwise, beneficiaries might be entitled to funds that it would be illegal to obligate.

ISSUES IN CONTROLLING MANDATORY SPENDING

Reformers who seek to control mandatory spending by changing the way it is treated in the legislative and budget processes have several criteria for judging how well the mechanisms that have been put forth would fulfill their ultimate goal of ironclad spending control. Yet those criteria may conflict, requiring trade-offs between them. It is useful to consider such trade-offs so that any potential mechanism can be assessed according to how well it achieves the overall intended effect.

Many reformers put the dependability of a spending control mechanism at the top of any list of necessary attributes. Those reformers want mechanisms without loopholes and "escape hatches" to ensure that the level of mandatory spending agreed to on a particular date is attained. Consider, for example, the role played in the budget process by projections. Determining levels of spending in future years depends on projections of future-year variables, and those projections are inherently imprecise. If changes in the legislative or budget process (or both) can reduce policymakers' dependence on future-year projections or diminish the sensitivity of programs to economic changes, the goal of improved control will be easier to achieve.

Another attribute that some reformers consider vital is flexibility. Legislators might, for example, wish to pick and choose which programs to restrain at any given time; alternatively, they might want to delay reductions in funding during economic downturns. Many of the proposals for change address that issue by including explicit provisions that reduce or eliminate spending cuts in times of economic distress. In addition, most proposals insulate certain programs (in particular, Social Security) from the budget axe by granting them special rules or exemptions.

A third attribute that some policymakers value is accountability--in other words, a sense of "fair play" within the control mechanism. For example, some reformers

7. There are exceptions to this rule (such as Pell grant appropriations) in which programs have borrowing authority and forward-funding capabilities that effectively allow them to borrow from future-year appropriations.

believe that it is unfair to penalize programs in one area for spending overages in unrelated areas, as can happen with an across-the-board sequestration that is triggered by overspending on a handful of programs. Those reformers argue that enforcement should be targeted toward the individual programs or spending areas responsible for increases, which would require legislators and committees with jurisdiction for those programs to maintain control of them. Fairness in this context has nothing to do with changes in the well-being of beneficiaries but rather with fairness to legislators and committees.

Another characteristic of a control mechanism that is important to many Members is simplicity. The budget process is already quite complicated and time-consuming, and a legitimate concern is that a control mechanism might make it even more so. In addition, a complicated mechanism would be easier to circumvent than one that was simpler and more transparent.

Finally, the credibility of the enforcement procedure built into the mandatory spending control mechanism is a concern for some observers. Penalties in the mechanisms have generally been designed to be serious enough to impel legislators to avoid them. But critics argue that in some circumstances, legislators might waive those penalties, once they were triggered, because they would be too harsh to enforce. In that case, control might be only sporadic and would depend more on legislative preferences than on the mechanism itself.

Using the Criteria to Evaluate Currently Available and Proposed Mechanisms

It is easy to see that many of the criteria for evaluating mandatory spending control mechanisms conflict with each other, which creates fundamental tensions in designing such a mechanism. On the one hand, a mechanism that ensures a particular level of spending sacrifices some flexibility; on the other, a mechanism that is less rigid risks the use of that flexibility to avoid spending control. A method that protects certain programs may do so to the detriment of unprotected ones, forcing them to bear a disproportionate--and in some views, unfair--burden. To enforce compliance, the mechanisms must carry severe penalties; yet those penalties must be credible when the time comes to impose them. Finally, all of the above tensions relate to the mechanism itself. However, the proposals' differing impacts on the underlying social goals of the programs' proponents should also play a role in the design of a control mechanism.

Dependability. No control option can promise to achieve a particular amount of deficit savings, because to some extent, all estimates of spending rely on uncertain future-year projections. However, some mechanisms rely less heavily on projections

than do others, and some methods attempt to enforce a particular level of comprehensive limits on projected expenditures whereas others do not.

Some of the mechanisms that were discussed earlier (the PAYGO rules and the approaches in the Armey, Visclosky, and Cox bills) are automatic; others (the reconciliation process, fail-safe provisions, block grants, and the approach in the Spratt bill) are optional. Optional mechanisms usually rate poorly on the criterion of dependability precisely because they are optional. Mechanisms that rely on automatic enforcement offer, at least in theory, greater dependability. But the Balanced Budget Act's failure to control spending showed that even so-called automatic control mechanisms may not work that way in practice. Perhaps the Armey plan has a better chance of success than the Balanced Budget Act had because its sequestration mechanism is more detailed and might be feasible, at least in the current Congressional climate. Still, the Congress might find ways to avoid any severe sequestrations triggered by the plan (just as it did under the Balanced Budget Act). The Visclosky proposal uses global sequestration only as a fallback position, encouraging committees to come up with the necessary changes beforehand. Indeed, imposing discipline at that level might lead committees to consider spending cuts in anticipation of a more narrowly targeted sequestration, which would increase the chance that the mechanism would be effective.

The Cox approach would ensure a fairly firm level of control in the sense that once spending levels for individual programs had been determined, no further action would be necessary on the part of the Congress to enforce those decisions. However, under the Cox plan, no explicit level of maximum spending would be set in advance. In election years (that is, every other year), legislators might have a considerable incentive to increase spending, as they used to for Social Security programs before automatic cost-of-living adjustments were instituted. Therefore, the Cox plan could not guarantee that the level of spending legislators decided on would be lower than current or projected levels; in fact, spending could be higher.

<u>Flexibility</u>. Mechanisms that are optional and that are not enforced automatically clearly rate high on the criterion of flexibility, in part because they allow decision-makers to pick and choose programmatic changes that will produce the required savings. In addition, optional mechanisms operate on a year-to-year basis, making it easier for policymakers to respond to current economic conditions. Including fail-safe provisions in original legislation offers a different type of flexibility: that approach permits committees to consider exactly which cuts are appropriate in the event of excess spending. Of course, if the time for cuts arrived and the prespecified reductions were not deemed appropriate, the legislation would have to be changed to avoid the cuts. It might be more difficult politically to carry out the cuts in individual programs than to execute all the cuts together, as in reconciliation.

The block-grant approach offers a third type of flexibility. States could use the grant dollars as they wished, but the Congress would lose virtually all of its ability to set policy for programs that had been turned over to the states. Because the same program would fare differently in different states, it would be impossible to determine in advance the trade-offs that states would make in allocating funds among those programs.

Mechanisms that attempt to provide automatic enforcement may seem inherently more inflexible than those that are optional; however, the nation's experience with the Balanced Budget Act showed that some enforcement mechanisms may be less rigid than they appear to be. The PAYGO process is flexible at several levels: the costs of new legislation can be offset by other mandatory spending reductions or by tax increases chosen by the authorizing committees, and the amount to be sequestered may be reduced or eliminated as a result of economic or technical changes. But the PAYGO process does not permit the Congress to consider trade-offs among years, which might be appropriate for some programs. Furthermore, the PAYGO rules do not allow trade-offs between mandatory and discretionary programs, which are considered under separate sets of rules. The Armey plan would have some built-in flexibility, given that the maximum sequestration amount differs among programs; however, some people would argue that this feature only makes the plan inflexible in a different way. Further evidence of flexibility might be found in the fact that the Armey proposal would allow spending to increase based on hikes in inflation and in the eligible population.

The Visclosky approach offers at least some flexibility since the spin-off law is a built-in option. In addition, the approach allows for adjustments based on increases in inflation. If a spin-off law was enacted, the committees would be directly responsible for determining which programs should be cut (or which revenues increased).

Finally, the Cox plan offers yet another type of flexibility in that levels of spending under its approach are decided on explicitly for each year. But under that plan, the Congress would transfer to the heads of executive branch agencies much of its flexibility to determine the details of individual programs. In particular, it would lose its ability to decide how programs would be cut when money fell short.

Accountability. Mechanisms with across-the-board sequestrations can lead to situations in which the programs that are causing the unexpected increases in spending are not held accountable for those overages. Even if the sequestration was triggered by only a handful of programs, all would face reductions under an across-the-board action. In that kind of system, incentives for committees to make cuts that they were certain would lead to decreased spending would not be as strong as they might be. The reason is that committees would be encouraged to "free ride" off the

savings created by other committees, who would share the burden if spending was higher than it should be. Protecting some programs would make the mechanism even more unfair for the remaining unprotected ones.

This problem would occur with the Armey plan, for example, even with its different maximum sequestrations for different program areas. The Armey bill would add considerable uncertainty to the spending process because large, unanticipated outlays in one program could lead to reductions in other, unrelated programs. For example, suppose that Medicaid was the only program whose expenditures exceeded expectations and that they were too high by 5 percent. Those conditions would trigger a sequestration. However, under the plan, Medicaid could be reduced by only 1 percent; consequently, other programs might be forced to absorb larger percentage reductions to make up the difference.

The opposite end of the spectrum of accountability is presented in the Visclosky approach. Under that plan, if a spin-off law was enacted and a committee did not abide by the changes that the spin-off law put into place, that committee's programs would be the only ones to suffer. Some observers might suggest that such a procedure goes too far, and that holding committees fully liable for spending overages in their program areas could result in excessive burdens on programs that were obviously being used more heavily than the Congress originally anticipated. Perhaps most important, jurisdictional issues between the two houses of Congress would have to be resolved.

The Cox approach would shift a great deal of accountability to the executive branch agencies, with agency heads being responsible for ensuring that their programs did not overspend. In theory, agencies would not spend more than the amounts appropriated for their programs. If they did, then the Congress might still be held accountable; however, it is also possible that agency heads might be blamed instead for not implementing the proper changes. Similarly, if spending did not exceed the appropriated amounts because of reductions in services, agency heads might be held accountable, although some people might feel that, regardless of any delegations of power, the Congress was ultimately responsible for program activities.

Optional mechanisms and strategies such as reconciliation and the Spratt approach, if they were exercised, would make committees accountable for controlling projected spending. But because optional approaches usually do not include any kind of automatic enforcement, they cannot hold anyone accountable for spending overages. In contrast, fail-safe provisions would hold committees accountable for increases in spending, but only to the extent that the committees chose to use such provisions in the first place.

Simplicity. Systems (such as reconciliation and the Spratt proposal) that encourage the Congress to consider spending changes as a package add a considerable layer of complexity to the budget negotiation process because the reconciliation bill is generally quite large and laden with controversial proposals.[8] Plans that use a sequestration for enforcement (for example, the Armey bill) could also affect negotiations on the budget and might lead to complex maneuvering when the time came to implement the sequestration. The advantages of the Visclosky approach come at the price of yet another layer of budgeting rules and procedures: the approach is difficult to understand at first (or second) glance, and the spin-off process is itself quite complicated.

In theory, block grants would be relatively simple to execute and could remove some contentious decisions from the annual Congressional agenda. The Cox approach also simplifies the legislative process, although the approach introduces potential political complications as well. The procedures under the Cox plan are simple; however, that approach might be the most time-consuming of all, because the Congress could be deadlocked in debate over controversial programs each year.

Credibility. Two types of credibility are relevant to the proper choice of a mandatory spending control mechanism. First, one must consider the credibility of the enforcement mechanism itself; as discussed earlier, it relates to dependability. A broader issue to consider is that some mechanisms with automatic enforcement of restraints on mandatory spending could place the government in the position of reneging on benefits it had previously agreed to provide. For example, explicit caps on spending might force the government to break promises it had made in law.

It is not clear what the Congress would do when faced with the prospect of a mandatory spending control mechanism such as a cap that would actually limit further spending in a given fiscal year. There are two possibilities: either an automatic enforcement component would be triggered to reduce spending, or the Congress would change the mechanism (or circumvent it) to accommodate the increase in spending implied by the law. If the Congress viewed obligations established in legislation in the same light as contractual obligations (or if it believed that voters viewed them that way), it might attempt to raise or avoid the caps. Most people seem to view the benefits of some mandatory spending programs, such as Civil Service Retirement and Social Security, as earned benefits that the government is morally obliged to pay, even if it is not legally required to do so. Whether the avoidance of spending controls would become a regular event (similar to the increase in the debt ceiling) is an open question. Similarly, whether legislation to avoid

8. The Byrd rule in the Senate offers some control by restricting extraneous provisions in reconciliation bills. Although the rule does not apply directly to the House, it applies to conference reports and thus indirectly constrains the actions of the House as well.

spending caps would be used as a vehicle for reforming the budget process is also unclear.[9]

Other Considerations

In addition to the criteria discussed thus far, broader issues must be considered when evaluating mandatory spending control mechanisms: in particular, assessing the impact that proposed mechanisms might have on the social safety net and long-term planning, and determining whether a mechanism would create conflicts between laws or introduce improper delegations of spending authority.

Effects on the Social Safety Net and Long-Term Planning. The flexibility inherent in the optional approaches (such as the reconciliation process) implies that in times of economic trouble, appropriate programs can be sustained. In contrast, automatic enforcement components--in particular, sequestrations--have potentially large implications for the social safety net because it is precisely during cyclical downturns that spending for the programs that the net comprises is expected to be high. If sequestration reduced benefits automatically without regard for economic conditions, the "cushion" provided by mandatory spending programs would be smaller. Of course, a sequestration can be designed to have more or less impact on particular programs. (For example, arguments that the Armey proposal would eliminate the social safety net founder because means-tested programs under the plan would be limited to reductions of 1 percent.) If anything, what can be said is that automatic sequestrations will make the net more porous.

Keeping the safety net intact would mean undercutting the long-term planning goal of mandatory spending programs. With the exception of Social Security, programs that are designed to promote long-term income stability and medium- and long-term planning, such as Medicare and the retirement funds, would be subject to more volatility than they would be if the safety net was subject to larger-scale sequestrations.

The implications for the social safety net of sequestrations by program area would probably be greater under the Visclosky plan than under the Armey approach. First, passing a spin-off law such as the one envisioned in the Visclosky bill would mean that when a safety net program went over its limit and triggered a sequestration, only that program (or related programs managed by the same committee) would be affected. Second, the Visclosky plan (unlike the Armey and

9. The analogy to the debt limit is not exact, in the sense that raising the debt ceiling is "must-pass" legislation and therefore often (although not this year) seen as veto-proof. In contrast, legislation to raise caps on mandatory spending would probably not be truly veto-proof if the President was strongly against mandatory spending increases.

most other proposals) would not exclude Social Security; nor would it set limits on the sequestration of means-tested programs or Medicaid. If one of the programs that are designed to promote income stability triggered a sequestration, that stability might be diminished. However, in contrast to a system of global caps, those programs would be reduced only by the amount by which they were "over"--they would not suffer further instability as a result of overspending by other programs. Thus, under a mechanism with sequestrations by program area, the overall burden of cuts could shift somewhat toward the safety net programs as compared with the distribution of cuts under the Armey plan.[10]

The implications for the safety net of moving to block-grant financing could well be quite broad. First, without federal direction, states could reduce or eliminate any programs they chose. More important, they could cut back on the money they allocated to safety net programs. Under current law, states can only receive funds when they spend some of their own money. If they received federal money without having to spend their own funds, as they would if federal funds were distributed in block grants according to current levels, the incentive for states to provide their own funds would be weakened. At the margin, the price a state pays for an additional dollar of welfare benefits under current law is less than a dollar because of federal matching funds; that price would rise to a dollar if the matching program was eliminated. Many states--in particular, poor states with large numbers of recipients--would probably reduce spending for welfare programs. With higher marginal prices, services would be cut. To complicate matters further, widening differences among states' welfare policies might spark increased migration between states.

Changing the open-ended nature of mandatory programs, as the Cox bill proposes, would affect both their inclusion in the safety net and their promotion of long-term stability. Without the open-ended feature, the social safety net would remain intact only as long as funds were available from appropriations. Supporters of programs that make up the net find that circumstance worrisome in the context of unexpected downturns in the economy. For example, if high levels of unemployment or inflation caused funds to be spent faster than the appropriators had originally anticipated, only limited funds might be available for the social safety net programs when they were needed most. In addition, subjecting mandatory spending programs to potentially large changes in their annual appropriations would be antithetical to the goal of enhancing long-term planning and stability. If the Congress determined benefit levels and program features annually, a considerable amount of uncertainty would necessarily be transferred from the federal government to the beneficiaries of current mandatory spending programs.

10. That conclusion rests on the specifics of the proposals discussed. If, for example, the sequestrations by program area were limited in some way, the conclusion would change accordingly.

Delegation of Spending Authority. Many of the proposed mechanisms delegate some spending authority to entities outside of the Congress; the amount of delegation differs for each proposal. Under the Spratt plan, for example, the President would simply be required to submit to the Congress recommendations for reconciliation (or to explain why the Administration was not recommending such changes) in the case of projected increases in spending. In those circumstances, if the Congress was delegating anything at all, it would be only the power to propose legislation--and it delegates that in many other situations. At the other extreme, under the Cox proposal, the Congress might delegate broad authority to agency heads to determine program rules; proposals to transform programs into block grants would delegate similar authority to the states. In between those extremes are examples such as the Armey bill, under which the executive branch would be charged with sequestering funds from the mandatory spending programs but would do so according to strict guidelines laid down by the Congress. Given current case law, the Supreme Court would probably rule that the delegation of spending power that is implicit in most of the plans for controlling mandatory spending is constitutional.

Conflicts of Law. Laws may come into conflict under some of the proposals.[11] In particular, under the Cox plan, the benefits authorized in legislation (and to which a group of recipients is therefore entitled) might not be available after the appropriated funds ran out; alternatively, some benefits might not be available at the levels implied by legislation for some or all recipients. Although predicting the outcome of a legal challenge in any particular circumstance is impossible, one could envision a situation in which a court gave greater priority to the underlying entitlement than to any subsequent cap on the total amount available for that benefit. Thus, any legislative proposal that did not address the issue explicitly would face a potentially successful legal challenge.

CONCLUSIONS

This paper has presented a catalog of options for controlling mandatory spending as well as salient criteria for evaluating those options. Fundamental tensions exist between the goal of mandatory spending control and the desire of some people to maintain what they consider to be positive characteristics of mandatory spending programs.

This paper does not recommend a specific mechanism. Instead, it evaluates each proposal according to the various criteria that observers generally agree are necessary

11. Although generally the most recent law is the one that prevails, there are situations in which conflicts could occur. For example, if the funding legislation and the substantive legislation for a program were passed as part of the same bill, neither would be more recent; the two laws would simply be inconsistent if the funds were insufficient.

for effectiveness. The reason reform is being sought through the budget process is that policymakers have observed that spending continues to grow and policies have not been altered enough to offset that growth. Consequently, proponents of reform believe that something must be done. That "something" might be to consider spending reductions in a new way, or to cut spending automatically, or to do something else. In any case, whatever is done through the budget or legislative process is a substitute for direct changes to legislation. On the one hand, if the reason for the lack of sufficient changes up to this point is that legislative incentives encourage lawmakers to shy away from such decisions, reforms in process might steer legislators in the direction they really want to go. On the other hand, if the reason for inaction is that legislators are not convinced that reduced spending for mandatory programs is worth the social or political costs, even the best-designed control mechanism may fail to rein in that spending.