Transparency and Control: Improving Financial Management in Congress

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before the
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Mr. Chairman and members of the committee, thank you for inviting me to testify today regarding the budget process and federal spending restraint.

Federal outlays have increased 45 percent in the last five years. The government has run deficits in 33 of the last 37 years. The costs of federal programs for the elderly are set to balloon and impose huge burdens on young Americans. Clearly, current budget procedures are not working very well. They are stacking the deck in favor of program expansion without regard to current and future tax burdens.

We can improve federal financial management by focusing on two key budgeting principles: transparency and control. These principles are sorely lacking in today's budget process. Huge spending bills are rushed through Congress, with many members and the general public unaware of the wasteful details. Spending is routinely increased despite massive and ongoing flows of red ink. And under current rules, reform-minded members have been unable to control the appetites of their spendthrift colleagues who devote their efforts to narrow parochial concerns.

The need to find budget savings and cut the waste will be intense in coming years. Members of Congress and the public need better information and more powerful tools to control spending and avoid a fiscal train wreck. Creating a new statutory cap on the growth in total federal outlays would be a good step toward increasing both transparency and control in the budget process.

Improving Transparency in Federal Budgeting

The subtitle of the hearing today asks whether Congress is transparent in the way it appropriates funds. Let me first praise the part of the current process that is quite transparent—the reporting of budget *aggregates* by the Congressional Budget Office and Office of Management and Budget. The regular budget updates from these agencies allow interested citizens to find out how much their government taxes and spends, how big the deficit is, and how fast the budget is growing.

Except for the big-picture data, everything else in the budget process is nontransparent. The process gets very confusing when Congress starts passing frequent supplemental spending bills, throws thousands of earmarks into bills and reports at the last minute, and makes most of the important spending decisions in behind-the-scenes horse-trading. Also, the language of federal budgeting is tough to decipher for average citizens and often has a pro-spending bias—consider phrases such as "spending cuts," "budget baseline," "not fully funded," "entitlement," and "trust fund."

Both liberals and conservatives should support making the federal budget process more transparent. An important reform would be to make information about the recipients of federal largesse more readily available. Whether it's earmarks, farm subsidies, corporate welfare, or grants to nonprofit groups, federal taxpayers deserve to know who is receiving their hard-earned dollars.

A few years ago, the *Washington Post* had to battle the Department of Agriculture with a lawsuit before the agency would reveal the list of farm businesses that received taxpayer subsidies. It shouldn't be that difficult for the public to find out how its money is being spent. The people have a right to know that the government is handing out their tax dollars to Ted Turner, David Rockefeller, Bernie Ebbers, and Ken Lay in the form of agriculture subsidies.[1]

Legislation (S. 2590) introduced by Sens. Tom Coburn (R-OK) and Barack Obama (D-IL) would create a federal database on the Internet that lists the names of the 30,000 groups that receive federal earmarks and other handouts, and the amounts received. That would be an excellent step toward helping the public understand where their tax dollars are going. Enron, for example, received hundreds of millions of dollars in corporate welfare from different federal agencies. Citizens need a comprehensive database so they can find out all the federal giveaways that are going to particular companies, groups, and congressional districts.

With federal corruption in the news these days, making data available is more important than ever. Full disclosure regarding the recipients of federal hand-outs is a good first step to reducing corruption.[2] The issue of transparency is not just about citizens understanding what members of Congress are doing, it is about members being alert to what other members are doing. Many members, for example, said that they were outraged by the pork-for-profit schemes of Rep. Randy "Duke" Cunningham (R-CA). Other members are now under investigation for similar schemes. With greater disclosure of pork spending, members might not get up to such mischief in the first place.

There are other reforms, particularly related to earmarks, that would improve budget transparency. These include requiring earmarks to be included in bill language (not report language), requiring earmark sponsors to be listed in bills, making public all earmark request letters, and making conference reports publicly available a few days ahead of floor consideration.[3] I'd like to see the end of all earmarking, but these reforms would be a good start.

Reformers often note, correctly, that Congress should do more oversight of the executive branch to stop waste, fraud, and abuse. But it is the public that does the oversight of Congress, and in this age of websites, blogs, and computer databases, there is no reason why citizens should not be given access to more comprehensive, real-time information to aid in the oversight of federal budget actions. Proposals like S. 2590 would be a real step forward for getting citizens involved in monitoring government in the Internet age.

New Procedures Needed for Budget Control

Congress is supposed to control spending, but spending has been completely out of control in recent years. Most of the budget consists of so-called entitlement spending, which is growing rapidly on automatic pilot. Discretionary spending is supposed to be under tighter control in the annual appropriations process. But we've seen an explosion in the cost of supplemental spending bills outside the regular budget process in recent years. In addition, some of the budget rules that we do have in place, such as the statutory debt limit, haven't created any serious constraint on spending or deficits.

Some people argue that new restrictions on the budget process are not needed because Congress has the power to restrain spending and balance the budget whenever it wants. But political scientists have long recognized that the self-interested actions of individual members often lead to overall legislative outcomes that undermine the general welfare.[4] Indeed, frequent statements and press releases by many members make it clear that their top priority is to aid targeted interests in their states and districts, not to legislate in the broad interests of all Americans. If left to their own devices, many members essentially become lobbyists and activists for their own narrow causes, and broader concerns, such as the size of the debt imposed on future generations, are ignored.

New and improved federal budget rules are needed to help channel the energies of members into reforms that are in the interests of average citizens and taxpayers. Without tight budget rules, Capitol Hill descends into an "every man for himself" spending stampede—a budget anarchy that creates uncontrolled budget expansion and soaring deficits.

The lack of adequate federal budget rules and constraints contrasts with the tighter budget environment in most states.[5] Virtually all the states have statutory or constitutional requirements to balance their budgets. Governors in 42 states have line-item veto authority. Most state constitutions include limitations on government debt. All the states are fiscally constrained by the need to prevent their bond ratings from falling. In addition, more than half the states have some form of overall budget cap or tax and expenditure limitation (TEL).[6] This form of budget constraint should be implemented at the federal level, as discussed below.

There have been numerous efforts to impose tighter controls on the federal budget. One reform effort was the 1985 Gramm-Rudman-Hollings Act. It established a series of declining deficit targets over five years, which if not met resulted in an automatic cut, or sequester, to a broad range of programs. Congress replaced GRH in 1990 with the Budget

Enforcement Act. The BEA imposed annual dollar caps on discretionary (annually appropriated) spending and "pay-as-you-go" rules on entitlement programs that required the cost of any program expansion to be offset elsewhere in the budget. Those rules contributed to restraint, but they have since expired.

Bolder efforts to control spending and deficits have been debated in Congress but have narrowly failed to pass. A balanced-budget amendment (BBA) to the Constitution was proposed in Congress as far back as 1936. In 1982 the Senate passed a BBA by a vote of 69-31. In addition to requiring budget balance, the amendment would have limited the annual growth rate in federal revenues to the growth rate in national income. Unfortunately, the BBA failed to gain the needed two-thirds approval in the House. At the time, a parallel effort resulted in resolutions being passed in 31 states calling for a constitutional convention to approve a BBA, but that effort came up three states short of the required number. In 1995 Congress again voted on a BBA, and it again failed. The BBA passed the House by a 300-132 margin but fell one vote short of passage in the Senate.

Capping Total Federal Spending

Today, reformers are focusing on statutory rather than constitutional efforts to control the budget. And unlike GRH and the BBA, today's efforts are focused on spending control, not deficit reduction, because of recognition that deficits are simply a byproduct of the more fundamental overspending problem. There are many good proposals to exert greater control over spending, including restoring budget impoundment, a sunset commission, and biennial budgeting.[7]

However, a more direct and powerful way to control the budget is to impose a cap on the growth in total spending.[8] A number of House members, including John Campbell (R-CA) and Todd Akin (R-MO), are considering introducing bills to place a statutory cap on the annual growth in total federal outlays, including both discretionary and entitlement outlays.

Note that the BEA imposed multiyear caps on discretionary spending but did not cap entitlement spending. Yet the rapid growth in entitlement spending is an important factor in today's high deficits and will likely cause a major budget crisis in the future. Entitlements account for more than half of the budget and should be included under any cap.

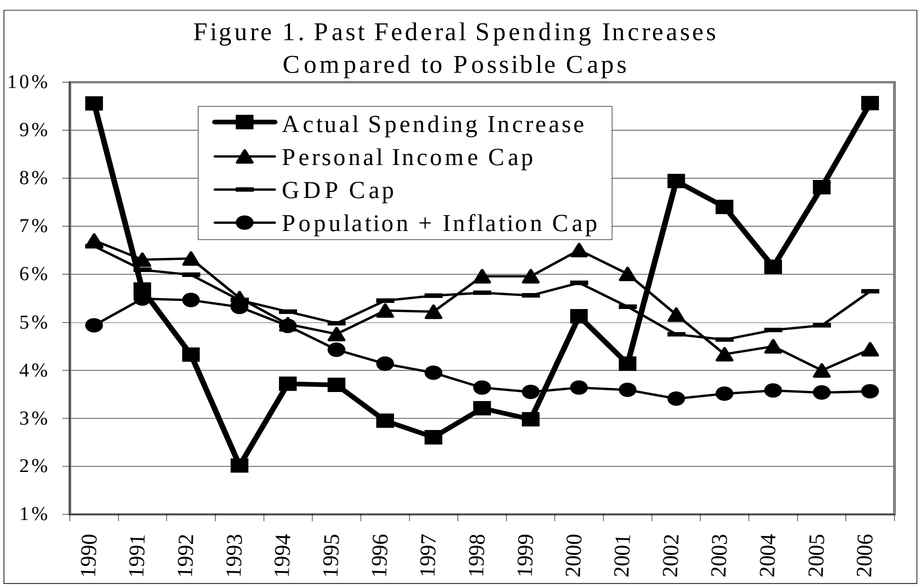
A cap and sequester mechanism on discretionary spending, as under BEA, is straightforward. But it is more complicated to sequester entitlement programs because spending is driven by formulas, reimbursement rates, calculated benefits, and other criteria. Thus, a spending cap law would need to spell out in some detail the particular procedures that agencies would follow to trim entitlement outlays if ordered by sequester. Legally, there is no problem with Congress capping and sequestering entitlements. Recipients of federal entitlement benefits are not legally entitled to their benefits, and Congress can freeze them or cut them at any time to get the budget under control.[9]

There was substantial interest in capping entitlements in the early 1990s. In 1992, the bipartisan Strengthening of America Commission, headed by Sens. Sam Nunn (D-GA) and Pete Domenici (R-NM), proposed capping all non-Social Security entitlement spending at the growth rate of inflation plus the number of beneficiaries in programs.[10] The Entitlement Control Act of 1994 (H.R. 4593) introduced by Rep. Charles Stenholm (D-TX) would have capped the growth in all entitlement programs to inflation plus one percent plus the number of beneficiaries. Both of those proposals included procedures for sequestering entitlement spending with broad cuts if the caps were breached.

Structuring a Cap on Federal Spending

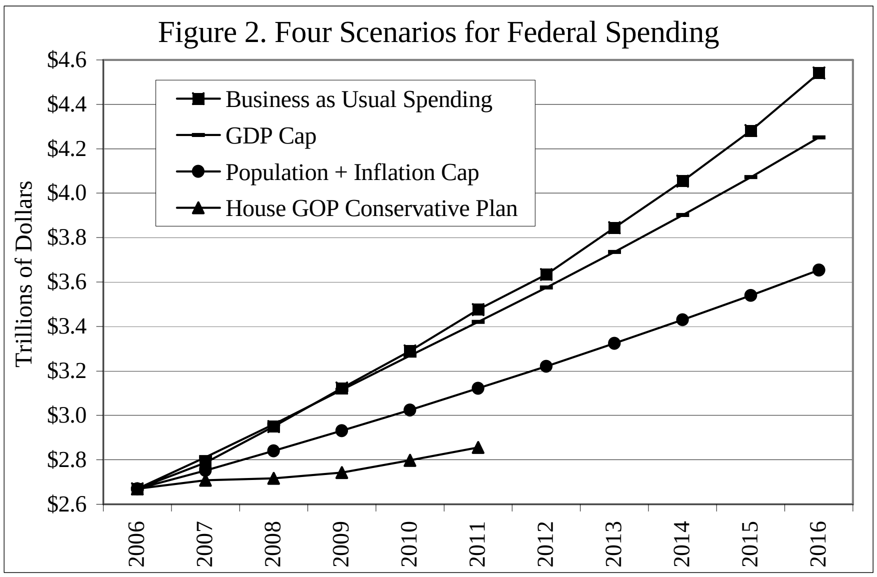
A simple way to structure a cap is to limit annual spending growth to the growth in an economic indicator such as gross domestic product or personal income. Another possible cap is the sum of population growth plus inflation. In that case, if population grew at 1 percent and inflation was 3 percent, then federal spending could grow at most by 4 percent.

Figure 1 shows actual federal outlay growth since 1990 compared to possible caps. The GDP and income caps would be looser than a cap based on population growth plus inflation. Whichever indicator is used should be smoothed by averaging it over about five years. The basic principle underlying all of these caps is that the government should live within constraints, as average families do, and the government should not consume an increasing share of the nation's income or output.



Source: Author, based on various government data. Spending is fiscal year outlays. 2006 data is estimated. Caps are five-year averages of indicators.

How might a spending cap constrain federal spending in the future? Figure 2 shows that any of the caps would reduce the growth of future spending compared to a business-as-usual scenario.[11] But the lower cap of population plus inflation would offer greater spending constraint. All of the caps would provide protection against a nightmare scenario of continued spending growth similar to the growth of recent years. But it is also true that a cap would not guarantee that Congress proactively made the large spending reforms that we need and eliminated wasteful programs in the federal budget. Note that in Figure 2 the House Republican conservative budget plan is a more responsible spending path that is below the cap amounts.[12] This plan would cut wasteful programs and bring the deficit down to zero over five years.



Source: Author. The two cap lines assume that spending would rise each year by the maximum amount allowed.

With an overall spending cap in place, Congress would pass annual budget resolutions and make sure that discretionary and entitlement spending totals were projected to fit under the cap for the upcoming fiscal year. If needed, reconciliation instructions would be included to reduce spending on entitlement programs to fit under the cap for the upcoming fiscal year and to reduce out-year spending to fit under projected future caps. The process could be strengthened by turning today's concurrent budget resolution into a joint budget resolution signed by the president, as the Bush administration has proposed.

The Office of Management and Budget would provide regular updates regarding whether spending is likely to breach the legal cap, and Congress could take corrective actions as needed. If a congressional session ended and OMB determined that outlays were still above the cap, the president would be required to cut, or sequester, spending across the board by the amount needed to meet the cap. The GRH and the BEA included sequester mechanisms that covered only portions of the defense, nondefense, and entitlement budgets. A better approach would be to cap all spending and subject all programs to a sequester should Congress fail to restrain spending sufficiently. But let's hope that, when sequesters were looming, Congress would make the needed cuts before sequestration actually took place.

The Advantage of Capping Spending

The Colorado Taxpayer's Bill of Rights, or TABOR, is a constitutional cap on state revenue growth. The annual growth in state tax revenues is limited to the growth in state population plus inflation. Any revenues that flow into the government above the cap must be rebated back to state taxpayers. TABOR has worked well in Colorado, but for the federal government a cap on spending is more appropriate than a cap on revenues. One reason is that state governments must balance their budgets each year, and thus a cap on revenues essentially becomes a cap on spending in the states. By contrast, the federal government runs large deficits, and thus a cap on revenue growth would not limit the overall budget or deficits.

One advantage of capping federal spending rather than revenues or deficits is that spending is quite stable and can be directly controlled by Congress. GRH tried to cap deficits, but deficits can swing wildly from year to year, and that can take policymakers by surprise. Indeed, one reason why GRH was scrapped was that there was a swing upward in the deficit projection and Congress was unwilling to allow a large and sudden sequester to occur. Regarding a cap on revenues, one cause of the recent controversy surrounding the TABOR cap in Colorado was the fairly rapid fall in state revenues during the economic slowdown a few years ago. A cap on spending avoids problems related to upswings and downswings in the economy because spending fluctuates less and is controlled directly by Congress.

Another difference between a spending and a revenue cap is that you do not need a taxpayer rebate mechanism under a spending cap. The tax rebate mechanism in Colorado has delivered substantial savings to taxpayers, but it has become a complex part of the state budget process because of special interest pressures to micromanage exactly who gets the rebates. By contrast, under a federal cap on spending, any savings would automatically go toward reducing the federal deficit and debt (just as with any spending restraint without a cap). In years with rapid revenue growth like this year, a spending cap would ensure that the federal deficit was sharply reduced. Congress would continue to have the option of cutting taxes whenever it wanted, but there would be no need for a complex rebate mechanism.

A final note: one shortcoming of a statutory spending cap is that Congress would have the option of rewriting the law if it didn't want to comply with it. In the past, Congress has often rewritten budget laws and found ways to get around budget restrictions when it wanted. But a cap on overall spending would be a very simple and high-profile symbol of restraint for supporters in Congress and the public to rally around and defend. Some budget laws have been too complex and hard for the public to understand. An overall cap on spending growth is easy to understand, and watchdog groups would keep the public informed about any cheating by Congress or the administration. A spending cap creates both transparency and control in federal budgeting. Over time, public awareness and budgetary tradition would aid in the enforcement of a cap.

Conclusion

Federal policymakers need both a change in mindset and tougher budget rules to ward of huge tax hikes or a financial crisis in future years as entitlement costs soar. They need to scour the budget for programs and agencies to eliminate.[13] A spending cap is part of the solution to get the budget under control and avert another federal spending orgy like the one of recent years.

Clearly, current budget rules have not worked very well, and we should experiment with new rules to try and get a grip on the overspending problem. Budget reforms such as biennial budgeting and establishing a sunset commission are good ideas that should be considered. But a cap on overall federal spending is more direct, more powerful, and easier for the public to understand.

Thank you for holding these important hearings. I look forward to working with the committee on its agenda for federal budget reform.

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[1] Chris Edwards and Tad DeHaven, "Farm Reform Reversal," Cato Institute Tax & Budget Bulletin no. 2, March 2002.

[2] Chris Edwards, "Reducing Federal Corruption," Cato Institute Tax & Budget Bulletin no. 34, May 2006.

[3] For a discussion on earmark reforms, see Tom Finnigan, "All About Pork: The Abuse of Earmarks and the Needed Reforms," Citizens Against Government Waste, May 3, 2006.

[4] For a discussion, see Chris Edwards, *Downsizing the Federal Government* (Washington: Cato Institute, 2005), chapter 6.

[5] For background on state budget processes, see National Association of State Budget Officers, "Budget Processes in the States," January 2002.

[6] Michael New, "Limiting Government through Direct Democracy," Cato Institute Policy Analysis no. 420, December 13, 2001.

[7] For some reform ideas, see Brian Riedl, "What's Wrong with the Federal Budget Process," Heritage Foundation, January 25, 2005. See also the Republican Study Committee's Family Budget Protection Act at www.house.gov/ryan/press_releases/2004pressreleases/family_budget_protection_act.htm.

[8] For background, see Brian Riedl, "Restrain Runaway Spending with a Federal Taxpayers' Bill of Rights," Heritage Foundation, August 27, 2004. See also Chris Edwards, "Capping Federal Spending," Cato Institute Tax & Budget Bulletin no. 32, March 2006.

[9] For a discussion, see Susan J. Irving, "Budget Policy: Issues in Capping Mandatory Spending," Government Accountability Office, GAO/AIMD-94-155, July 1994.

[10] The commission was sponsored by the Center for Strategic and International Studies.

[11] The business-as-usual scenario assumes that discretionary spending grows with GDP and that entitlement spending grows per the Congressional Budget Office baseline.

[12] House Republican Study Committee, "Contract with America: Renewed," March 8, 2006.

[13] For detailed discussion of federal programs that should be eliminated, see Chris Edwards, *Downsizing the Federal Government* (Washington: Cato Institute, 2005). See www.downsizinggovernment.com.