Senate Budget Committee Republican Staff
BUDGET BULLETIN
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INFORMED BUDGETEER

DEBT MANAGEMENT A LA RUBE GOLDBERG

- Federal government borrowing will reach the statutory limit of $7.384 trillion sometime during the month of October. Once the limit is reached, Treasury will be unable to increase borrowing, and the Secretary of Treasury will be unable to carry out his financial management responsibilities using the normal methods.
- The Government Accountability Office (GAO) was required (by the Consolidated Appropriations Act of 2004) to prepare a report reviewing the steps taken by the Department of the Treasury to avoid exceeding the debt ceiling during the last debt ceiling crisis which began in February and ended in May of 2003. GAO was also instructed to determine whether all major accounts used for debt ceiling relief had been properly credited or reimbursed.
- GAO issued its report in May 2004 (www.gao.gov/new.items/d04526.pdf), and found that all actions taken by Treasury in early 2003 were consistent with legal authorities provided to the Secretary. GAO also found that when the debt ceiling was increased, the Secretary fully restored interest losses and fully invested all uninvested principal and interest (for the Federal Employees Retirement System G-fund and the Civil Service fund), as required by law. Interest losses related to the Exchange Stabilization Fund (ESF) could not be restored without special legislation (which Treasury has since asked for but which has not been enacted); as a result, the ESF lost $3.6 million in interest.
- The actions that the Treasury Secretary took in early 2003 are summarized below; *Bulletin* readers can assume with some confidence that similar actions will be taken this month and next, until Congress acts to raise the current $7.384 trillion debt ceiling. (This has been done several times before; the *Bulletin* reviewed in June 2002 (budget.senate.gov/republican/analysis/2002/bb15-2002.pdf) how Treasury has carried on in similar predicaments.)
- The first action Treasury Secretary Snow took in February 2003 was to suspend investment of the Government Securities Investment Fund (G-fund) of the Federal Employees Retirement System. Secretary Snow also suspended reinvestment of some of the maturing obligations held by the Exchange Stabilization Fund (ESF).
- On April 4, 2003, Secretary Snow declared a debt issuance suspension period lasting until July 11, 2003, which allowed him to redeem $12.2 billion of the CSRDF Treasury obligations. On May 19, the Secretary extended the previously declared debt issuance suspension period until December 19, 2003, which allowed him to redeem an additional $20.2 billion of CSTF Treasury obligations.
- What is a "debt issuance suspension period," and how does it give the Secretary more options to manage funds when borrowing has reached the statutory limit?
- Subsection (k) of 5 U.S.C. 8348, enacted after the 1985 debt limit crisis, authorizes the Secretary to redeem securities or other invested assets of the Civil Service Retirement and Disability Fund (CSRDF) before maturity to prevent the amount of public debt from exceeding the debt ceiling. (Once an increase in the debt ceiling is finally inacted, the CSRDF must be fully restored to where it would have been if the disinvestment had not been made.)
- However, the same law also provides that, prior to disinvesting CSRDF assets, the Secretary must first determine that a "debt issuance suspension period" exists. A debt issuance suspension period is defined as any period for which the Secretary has determined that debt obligations of the U.S. may not be issued without exceeding the debt ceiling.
- Furthermore, the duration of the declared debt issuance suspension period is important, because the amount of CSRDF assets that the Secretary may disinvest is limited to the total amount of civil service retirement and disability benefits authorized to be paid during the debt issuance suspension period (roughly $4.2 billion per month is paid out in civil service retirement and disability payments).
- When the government last got close to the debt limit in February 2003, Treasury was able to coast along for a couple of months without declaring a debt issuance suspension period because of the timing of receipts coming into the government and by using other tools.
- By the time a debt limit increase was finally enacted on May 27, 2003, the Treasury had taken actions that enabled $105 billion in checks to go out. Without such actions, those checks would not have been cashable since Treasury was prevented from borrowing an equivalent amount because of Congress' failure to increase the debt ceiling. By the next day, Treasury had invested all uninvested funds of the G-fund, ESF and the CSRDF and restored the interest losses incurred by the G-fund. By June 30, Treasury restored the principal and interest losses incurred by the CSRDF that related to: 1) the failure to invest CSRDF receipts and, 2) redeeming obligations before they were needed to pay fund benefits and expenses.
- Since it is unlikely that Congress will raise the debt ceiling before it recesses on October 8, readers should expect Treasury to take actions similar to those in February - May of 2003. The timing of receipts vs. expenditures in October and November, however, is somewhat different than in February, March and April. This may prompt the Treasury Secretary to declare a debt issuance suspension period sooner than he had to during the 2003 debt ceiling crisis.
- The most likely scenario is that the debt limit will be increased during the lame duck session. The election will be over and perceived fears of a debt limit vote will have subsided.

BUDGET PROCESS MID-LIFE CRISIS

- On September 14, the Congressional Budget Office (CBO) held its third annual Director's Conference. CBO invited fiscal policy experts from Congress, academia and the private sector to the conference, the theme of which was "The Budget Act: The Next 30 Years."
- The first session, "Congressional Budgeting After 30 Years: Lessons Learned," was moderated by Norm Ornstein. Former Senate Budget Committee Chairman Pete Domenici spoke of budgeting as governing, and expressed his support for two-year budgeting.
- Former House Budget Chairman Leon Panetta said that the President must be engaged to get the process back on track, and that deficit reduction sacrifice must be balanced (tax increases or spending cuts alone won't work).
- Alice Rivlin, who was dubbed the "George Washington" of CBO, praised the budget process and said that the easy work has been done, and that the hard work of facing up to the long-term fiscal pressures of the baby boom is still ahead.
- The second session addressed whether the current budget process accurately reflects modern programs, transactions and financing mechanisms. George Washington University Professor Phil

Joyce moderated a discussion where Peter Fisher, former Treasury undersecretary, advocated accrual budgeting.

- University of Maryland (BC) Professor Roy Meyers suggested a new budget concepts commission, to include members from Washington, outside D.C., and outside the United States.

- Lindy Paull, Co-Managing Partner of PricewaterhouseCoopers and former chief of staff of the Joint Committee on Taxation, stressed that closer attention needs to be paid to so-called "tax expenditures" in order to understand the full picture of how taxes, or the lack of them, affect the budget.

- The final session looked toward the future and the budget process' ability to confront long-term fiscal challenges. Moderator Maya Macguineas, Executive Director of the Committee for a Responsible Federal Budget, said that the budget process needs transparency and controls in order to aid Congress in facing long-term issues.

- Peter Heller from the IMF said that the current budget system is strong, but he would like to see the annual budget resolution include specific figures on the health of Social Security and Medicare so that they would be voted on.

- Joe Humphreys, the staff director of the Social Security Advisory Board, was skeptical about loading the burden of long-term fiscal policy on the budget process and warned about relying too much on rules, which he suggests leads to ways to evade the rules.

- Gene Steuerle, Senior Fellow at the Urban Institute, said that the biggest error policymakers make is focusing on the deficit rather than good government. Steuerle believes that the budget process should work toward restoring more discretion to fiscal policy with less reliance on entitlements.

- Overall, all panelists agreed that no process is an adequate substitute for political will. Most agreed that the process has worked relatively well, especially discretionary spending caps and pay-as-you-go rules. And, several reminded the conference attendees that much hard work is still ahead.

GAO: $10 BILLION IN STATE RELIEF LESS THAN OPTIMAL

- In May 2003, the Congress and the President provided $20 billion in assistance to states by enacting the Jobs and Growth Tax Relief Reconciliation Act of 2003. Of the total, $10 billion in assistance was through the Medicaid program. The other $10 billion was for unrestricted, temporary fiscal relief to states to help close budget gaps, provide fiscal stimulus, or comply with federal mandates. A year ago (July 28, 2003), the *Bulletin* examined the argument that such federal assistance was necessary because states' fiscal problems were the fault of the federal government (http://www.senate.gov/~budget/republican/analysis/2003/bb16-2003.pdf).

- Since then, Senate Budget Committee Chairman Nickles asked the (recently renamed) Government Accountability Office (GAO) to study how states actually used the $10 billion in general assistance. GAO's report, issued in May, concluded that it is "too soon to fully assess the complete impacts of these payments" [emphasis added], but still offered instructive observations (http://www.gao.gov/new.items/d04736r.pdf).

- Before examining the $10 billion in detail, GAO looked at the cumulative experience of similar types of federal assistance extended to states in the past and the literature assessing the effects of unrestricted assistance on the behavior of state governments. GAO observed several "lessons learned." The stabilizing effect of such aid is limited if it comes after the trough of the recession or if it is not targeted to states most affected by the recession and least able to respond to it. Such federal aid can easily and invisibly be substituted for state funds. And states can come to rely on such aid instead of stabilizing their own fiscal houses.

- GAO then assessed how the timing and use of the $10 billion compared to these caveats. GAO concluded the fiscal relief was neither correctly timed nor accurately targeted to assist those states hit hardest by the recession. Fiscal relief was distributed to states nearly 19 months after the end of the recession, well after the national economy was rebounding, but before states were seeing increased employment. While probably helping some states with their budgetary problems, the payments were not "ideally timed to achieve their greatest economic stimulus."

- As for allocation, relief funds were distributed on a per-capita basis, with small-population states receiving minimum payments of $50 million. Distribution levels did not take into account key recessionary indicators such as gross state product and employment levels, thereby reducing the effectiveness of the assistance.

- As for substitutability, GAO viewed the $10 billion in unrestricted payments as analogous to the fiscal relief programs in the 1970s, such as the General Revenue Sharing program and the Antirecession Fiscal Assistance program. GAO interviewed 12 state budget offices in order to determine how the $10 billion in fiscal relief funds were used. Most states reported that these funds were used as general revenue, or put into their General Funds for either a specific use such as children's services, state police expenditures, or K-12 education funding. Unrestricted funds generally provide less budgetary relief to states, as there is no assurance that funding will be properly allocated to areas most in need. The report states that "once funds are commingled for budgeting purposes, it is difficult or impossible to identify the source of the dollars that fund specific expenditures."

- Finally, GAO warned that federal assistance – even if it had been better timed and targeted – could still have undesirable consequences, as moral hazard can result. The more that the federal government provides such assistance, the less incentive states have to set aside rainy day funds. Instead, they will wait for the federal government to bail them out.

- As the Congress makes fiscal decisions for 2005, perhaps some of these lessons learned will assist in allocating resources to their most optimal uses.