BUDGET REFORM PROPOSALS

15. BUDGET REFORM PROPOSALS

We are emerging from an era of fiscal irresponsibility, in which the process by which budget decisions were made and the ways in which they were presented helped expand deficits by trillions of dollars. The President's Budget represents a break from these process and presentational choices. For instance, where the prior Administration turned its back on certain budget enforcement principles that had fostered surpluses during the 1990s, this Administration will reinstate and improve upon those rules. And where the prior Administration presented budgets and budget baselines that failed to reflect the true year-to-year costs of, for example, overseas military operations or responding to natural disasters, this Administration employs a baseline and presents a Budget that more accurately reflects the costs of current or proposed policy going into the future.

The President's budget reform proposals can be grouped into three categories: First, we will adopt certain changes in the budget process, such as a statutory Pay-As-You-Go rule and a proposal for an optional, fast-track procedure for Congress to consider certain rescission requests, that will together help to impose greater discipline on revenue and spending policies. Second, we have made several changes in the display of the budget, such as emphasizing the metric of "debt net of financial assets" and reflecting the true up-front cost to the Government in its Troubled Asset Relief Program (TARP) transactions through net present value accounting, that will offer a clearer window into the liabilities and costs that the Government has and will incur. Finally, we have presented a revised baseline, which includes full-year rather than partial-year costs for overseas military operations as well as a statistical estimate of annual Federal costs for natural disasters, to better capture the likely costs of operating the Federal Government under current policy going forward.

Taken together, these reforms generate a Budget that is more transparent, comprehensive, and accurate, and is thus a better guidepost for citizens and their Government representatives in making decisions about the key fiscal policy issues we confront as a Nation.

Changes in the Budget Process

The Administration supports four proposals that would update the budget process laid out in the Congressional Budget Act of 1974: a renewed statutory Pay-As-You-Go rule, limits on the use of advance appropriations for discretionary programs, allocation adjustments that support the cost-efficient administration of mandatory programs and tax collection, and an option for the expedited consideration of certain rescission proposals.

Statutory Pay-As-You-Go.—The Administration supports a statutory approach to the Pay-As-You-Go or PAYGO rule, to complement and reinforce the point-of-order constraints agreed to by the House and the Senate in 2007.

The PAYGO principle requires that legislation increasing mandatory spending must be fully offset, or "paid for," by legislation reducing mandatory spending or increasing revenues. Likewise, legislation reducing revenues must be fully offset by legislation raising revenues or reducing mandatory spending. In short, the net of all tax and mandatory spending legislation must be budget neutral.

Drawing closely on the PAYGO law enacted in 1990, the Administration suggests that the requirement of budget neutrality be enforced by an automatic reduction or "sequestration" of selected mandatory programs if legislation is enacted that violates the PAYGO rule. If triggered, such a penalty would restore budget neutrality. But the real purpose of such a penalty is to discourage the enactment, or even the consideration, of legislation that would violate the PAYGO rule. During the 1990s, the rule was adhered to without a sequestration having to be employed.

The Administration's PAYGO proposal differs in a few ways from the House and Senate PAYGO rules. First, the Administration believes that compliance with PAYGO is better measured relative to a baseline that makes budget projections based on current policies—policies in effect in 2009—rather than on policies scheduled (but unlikely) to be in effect in later years (see the discussion of baselines in this section). Second, the Administration would enforce the statute year by year rather than bill by bill (thereby allowing costs in one bill to be offset by savings in another). Third, the Administration would require the total cost of PAYGO legislation to be budget neutral in each year 2010-2013, rather than over a period of years. In contrast, the House and Senate rules each require budget neutrality only over a six-year and an 11-year period.

Administrative PAYGO.—The Administration will continue to review potential administrative actions by Executive Branch agencies affecting entitlement programs, as stated in a memorandum issued on May 23, 2005, by the Director of the Office of Management and Budget. This effectively establishes a PAYGO requirement for administrative actions involving mandatory spending programs. Exceptions to this requirement are only provided in extraordinary or compelling circumstances.

Program integrity funding.—As explained on pages 40-41 of the Budget document, *A New Era of Responsibility: Renewing America's Promise*, the Administration requests discretionary budget authority of $1,911 million for program integrity purposes—funds that increase agencies' ability to ensure that entitlement benefits go to the proper beneficiaries in the proper amounts, and that taxes are collected on the same basis. These initiatives have been demonstrated to save more than they cost, and the savings are reflected in the Budget totals. The Administration requests that these amounts be allocated to the Appropriations Committees in a separate category, available only for the specified purposes.

Limit on advance appropriations.—An advance appropriation first becomes available one or more fiscal years beyond the year for which the appropriations act was passed. Budget authority is recorded in the year the funds become available for obligation, not in the year the appropriation is enacted. There are legitimate policy reasons to use advance appropriations to fund programs. For example, education grants are sometimes funded as advance appropriations to provide certainty of funding for an entire school year, since school years straddle Federal fiscal years. However, advance appropriations can also be used in situations that lack a programmatic justification, simply to make room for expanded spending within the spending allocations set under the congressional budget resolution. This frees up room in the budget year but exerts pressure for increased spending in later years. To curtail these impacts, congressional budget resolutions since the 2001 Resolution have set limits on the amount of advance appropriations. The Administration proposes a limit on advance appropriations of $28,857 million for 2011 and freezes them at this level in subsequent years.

In addition, the Administration would allow advance appropriations for the Corporation for Public Broadcasting, which is typically enacted two years in advance, and for Veterans Medical Care. The Administration will work with the Congress to develop a specific advance appropriations proposal for the Department of Veterans Affairs Medical Care program.

Expedited process for considering rescission requests.—The President and Congress can and do use the normal legislative process to consider requests for the rescission or cancellation of funds that were previously appropriated but have, for example, proven to be in excess of amounts actually needed or of lower-than-expected value. However, there would be a benefit to establishing the option of an additional procedure in those cases where the President finds a need for a rapid, up-or-down vote on a package of rescission proposals.

Under this new proposal, the President can choose to send a limited number of packages of rescission requests to Congress for fast-track procedure. If he chooses to send a package under this special procedure, then the rescission proposals can only reduce or eliminate funding for budget accounts, programs, projects, or activities; the President could not redirect funds or change their allowable uses. The House would be required to vote on that package as transmitted, without amendment, within 15 days. If the package passes the House, the Senate would consider the same package, again without amendment, within 8 days.

Changes in Budget Display

The Budget and supporting material include a more insightful display of publicly held debt and the TARP, the International Monetary Fund, Pell Grants, and transportation programs related to aviation and the highway trust fund.

Debt Held by the Public Net of Financial Assets.—In the *Updated Summary Tables* volume, Summary Tables S-1 and S-14 display both debt held by the public and debt held by the public net of financial assets. Borrowing from the public is normally a good approximation of the Federal demand on credit markets. However, it provides an incomplete picture of the financial condition of the Government. Some transactions that increase the Federal debt also increase the financial assets held by the Government. For example, when the Government loans money to a private firm or individual, the Government acquires a financial asset that provides a stream of future payments of principal and interest. At the time the loan is made, debt held by the public reflects only Treasury's borrowing to finance the loan, failing to reflect the value of the loan asset acquired by the Government. In contrast, debt held by the public net of financial assets provides a more accurate measure of the Government's net financial position by including the value of loans and other financial assets held by the Government. This measure is especially useful during times, like the present, when the Government is borrowing large sums of money to address difficulties faced by the economy and financial markets. As shown in Summary Table S-14, a large share of the Government's current and recent borrowing has financed the purchase of financial assets, so that the increase in debt held by the public net of financial assets is noticeably smaller than the overall increase in debt held by the public.

TARP transactions.—The President's Budget reflects costs for the TARP on a net present value basis, with adjustments to the discount rate for market risk, pursuant to the authority in the 2008 Emergency Economic Stabilization Act (EESA). Net present value budgeting for TARP equity purchases captures the lifetime expected net cost of the program up front, rather than reflecting the cash impact in each year. (Programmatic and interest costs of a transaction sum to the same total over time whether they are shown on a present value basis or a cash basis; under neither approach do any costs to the Government disappear from the budget. The advantage of net present value scorekeeping in TARP and similar cases where financial assets are acquired is that the net costs to the Government appear at the time the transaction actually occurs.)

Full cash flows to and from the Government are still reported as a means of financing in the Budget and the Monthly Treasury Statement. The Budget would have shown a much higher cost in 2009 and large offsetting receipts in subsequent years—producing a steeper trajectory of falling deficits—if TARP had been shown on a cash basis. Such a cash portrayal would therefore have made it appear that the Administration was even more successful at bringing down deficits from year to year. But cash scoring for equity purchases, though perhaps advantageous for cosmetic reasons in this case, does not do as good a job as present value scoring in reflecting the expected costs of these transactions. Chapter 7, "Credit and Insurance," includes the analysis required under EESA, including the cost of TARP activities substituting cash-based estimates for transactions reflected on a credit basis in the budget.

IMF quota subscription and increase in the New Arrangements to Borrow.—The Administration supports a set of reforms being undertaken at the International Monetary Fund (IMF), including a realignment of country voting weights, which requires the United States to increase its quota subscription in order to maintain its current voting share of 16.7 percent. In addition, the G-20 has called for a very substantial increase in the New Arrangements to Borrow (NAB). Because these are exchanges of financial assets, the Administration does not score them as budget authority or outlays, and they are not included in the total funding requested by the Administration. The treatment of such increases as budget authority is analytically incorrect. Budget authority is the authority to enter into obligations that are liquidated by outlays. These transactions do not result in outlays, undercutting any rationale for scoring the transaction as budget authority. The Administration's position follows the recommendation made by the 1967 President's Commission on Budget Concepts that "Subscriptions, drawings, and other transactions reflecting net changes in the U.S. position with the International Monetary Fund should be excluded from budget receipts and expenditures."[1] There is little or no conceptual basis for treating IMF quota subscriptions or NAB increases differently from other financial asset exchanges, such as deposits of cash in Treasury's accounts at the Federal Reserve Bank or purchases of gold, which are not recorded as either budget authority or outlays.

Pell Grants.—The Administration requests that Pell Grants be converted to a mandatory program for 2010 and that benefits be substantially increased. Therefore, the 2010 request of $1,263 billion in discretionary budget authority includes no funding for Pell Grants. For year-to-year comparability, Summary Tables S-3, S-4, and S-7 in the *Updated Summary Tables* volume also treat existing Pell Grant funding and expenditures for 2008 and 2009 as mandatory. Classifying Pell spending consistently in all years in the baseline and the policy estimates makes it easier to understand the budget impact of the policy proposal. If these tables had instead shown Pell Grants as discretionary through 2009 and as mandatory in subsequent years, it would have been harder to understand the proposal for Pell Grants and harder to interpret the total level of year-by-year funding for other nondefense discretionary programs. Had the Budget not requested the conversion of Pell Grants to a mandatory program, it would have requested an additional $17.223 billion in discretionary budget authority for 2010.

Aviation user charges.—Beginning with 2011, the Budget assumes that certain aviation excise taxes will be replaced with user charges that would offset discretionary budget authority and outlays. The Administration believes that the Federal Aviation Administration's (FAA) financing system should move toward a model where charges are based on their costs, system users pay their "fair share," and FAA utilizes the funds directly to pay for the services that the users need and want. While these effects are largely offsetting, they appear in two

1 *Report of the President's Commission on Budget Concepts*, Washington, D.C., October 1967, p.31.

Table 15–1. PROPOSED BUDGET AUTHORITY AND OUTLAYS FOR PELL GRANTS
(In millions of dollars)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2010-19
Baseline:											
Budget Authority	21,322	20,795	23,056	18,435	22,965	23,396	23,938	24,586	24,941	25,301	228,735
Outlays	26,190	26,638	21,487	21,786	19,705	23,037	23,539	24,109	24,676	25,035	236,202
Policy:											
Budget Authority	21,131	30,857	32,328	33,569	35,418	37,234	39,157	41,182	43,255	45,598	359,729
Outlays	26,104	29,216	31,234	32,649	34,056	35,890	37,734	39,684	41,722	43,867	352,156
Change:											
Budget Authority	–191	10,062	9,272	15,134	12,453	13,838	15,219	16,596	18,314	20,297	130,994
Outlays	–86	2,578	9,747	10,863	14,351	12,853	14,195	15,575	17,046	18,832	115,954
Memorandum: Effect of Proposed Reclassification											
Discretionary:											
Remove Pell Grants from appropriated category [1]	–23,304	–22,998	–17,860	–18,091	–18,417	–18,748	–19,086	–19,430	–19,779	–20,135	–197,848
Mandatory:											
Add Pell Grants to mandatory category	23,304	22,998	17,860	18,091	18,417	18,748	19,086	19,430	19,779	20,135	197,848
College Cost Reducation and Access Act	2,886	3,640	3,627	3,695	1,288	4,289	4,453	4,679	4,897	4,900	38,354
Make Pell Grant funding mandatory and increase and index maximum awards	–86	2,578	9,747	10,863	14,351	12,853	14,195	15,575	17,046	18,832	115,954
Total Pell Outlays	26,104	29,216	31,234	32,649	34,056	35,890	37,734	39,684	41,722	43,867	352,156

[1] Includes outlays from unobligated balances of budget authority provided in the American Recovery and Reinvestment Act.

ACQUISITION OF FINANCIAL ASSETS

There are a number of circumstances in which the Treasury disburses cash and receives financial assets in return. In some cases, these transactions are recognized as an exchange of financial assets and so are not considered budgetary transactions at all; rather they are considered non-budgetary financing transactions. Purchasing gold, depositing Treasury operating cash in "tax and loan" accounts, or depositing cash with the Federal Reserve are examples of such transactions. In each case, borrowing from the public is higher than it would be if the transaction did not occur, but the extra borrowing does not represent extra spending or a higher deficit because the financial asset acquired by the Treasury fully offsets the liability of extra debt incurred by the Treasury.

Direct loans are a similar example; in those cases, the Treasury disburses cash (makes a direct loan) to a borrower (e.g., students, farmers, small businesses, etc.) and receives in return a loan asset or IOU from the borrower. In most cases the risk of default (and perhaps an interest-rate differential) makes the loan asset worth less than the cash disbursed by the Treasury. The difference in value represents the loss, or cost, the Government is expected to incur on such transactions. Put differently, the difference in value represents a subsidy to the borrower. The Government measures the costs or subsidy by discounting to the present the estimated present and future cash flows related to the loan contract and records the amount of subsidy as an outlay. Present value scorekeeping is used precisely because it is a method of comparing the value of future cash flows with an equivalent amount of up-front cash. Chapter 25, "The Budget System and Concepts," discusses this subject in more detail and Chapter 7, "Credit and Insurance," provides more information on credit programs.

Two other, similar examples are the TARP and the National Railroad Retirement Investment Trust. In each of these cases, the programs can acquire private-sector equities or equivalent financial instruments, and in each case, Congress legislated scorekeeping methods that do not show the purchase prices as an outlay.

Budget scorekeeping rules have not, however, fully incorporated the broad principle that the value of an acquired financial asset should be recorded as an offset against the cost of its acquisition. As a result, the cash paid to acquire stock in Fannie Mae and Freddie Mac has been recorded as a pure outlay (and increase in the deficit) with no recognition at the point of purchase that the stock has some positive, offsetting value. Dividends projected to be paid by the two entities will appear as cash inflows and reduce the deficit in later years. Likewise, if and when that stock is later sold to the public, the cash received in return will look like a reduction in the deficit. Over time – and accounting for interest on the cash flows – present value or subsidy scorekeeping produces the same total effect on the deficit as cash scorekeeping. The former may be preferable, however, because it means that the Government records the full expected cost of a transaction up front, when it occurs. The same reasoning suggests that the use of the budget to allocate public resources would benefit from up-front or present value scorekeeping.

For this reason, the Administration plans a comprehensive review of these types of transactions, with the goal of making the scorekeeping more consistent across the Government. Doing so may necessitate imposing controls or limits that may not now exist, so that the purchase of assets will occur only for the policy reasons and in the magnitude that the Government believes is appropriate, and so that future cash flows are estimated using sound methods that appropriately account for risk.

places in budget figures for technical reasons; as a revenue reduction shown in Summary Table S-11, and as a decrease between 2010 and 2011 in discretionary budget authority for the Transportation Department shown in Summary Table S-12. Had estimates associated with new user charges not been included, the amount of discretionary budget authority in Summary Table S-12 would have been higher by the following amounts (in millions of dollars):

2011	2012	2013	2014	2015	2016	2017	2018	2019
9,634	10,131	10,639	11,013	11,411	11,824	12,254	12,701	13,165

Highway Trust Fund.—The Administration is working to develop a comprehensive approach for surface transportation reauthorization. Consequently, the Budget contains no policy recommendations in this area, but rather displays baseline funding and current law revenues for surface transportation programs—most of which are funded through the Highway Trust Fund (HTF). To reflect the growing imbalance between projected HTF revenues and baseline spending in the most transparent manner, the Budget shows only the level of HTF funding that can be supported while maintaining positive annual cash balances in the trust fund. The additional funding for HTF programs is shown as discretionary budget authority from the

General Fund. Specifically, for 2010 the Budget includes $5 billion in contract authority and obligation limitation and $36 billion in discretionary Budget Authority for the Federal-Aid Highways program. This approach is used for both highway and transit programs over the 10-year budget horizon. Again, this presentation does not represent the ultimate funding levels or budgeting approach that the Administration and Congress necessarily should or will adopt for the upcoming reauthorization. Rather, its purpose is to accurately depict the condition of the HTF and recognize that, under current law, maintaining baseline spending would require support from the General Fund.

Improved Definition of Baseline

The Administration also suggests improving a few of the concepts used in formulating baseline projections to make the resulting product of more use to the public and to policymakers. Because the baseline sometimes plays a part in budget enforcement (as when PAYGO legislation is measured relative to a baseline), these suggestions would both improve the display of budget material and improve the budget process.

For years the baseline used by Congress has followed the definition contained in section 257 of the Balanced Budget and Emergency Deficit Control Act of 1985, often referred to as the Budget Enforcement Act (BEA) baseline. However, the BEA baseline does not accurately reflect a continuation of current policy. The Administration built its budget proposals starting from a baseline that adjusts the BEA baseline to better represent current policy, and recommends that Congress, the Congressional Budget Office, and the public use such a baseline in their own analyses as well. The deficit impacts of the adjustments to the BEA baseline are summarized in Summary Table S-6 of the *Updated Summary Tables* volume of the Budget. The adjustments are described below. Further detail about the adjusted baseline is provided in Chapter 24, "Current Services Estimates," of this document.

Shift Pell grants from discretionary to mandatory.—The baseline used by the Administration reflects the reclassification of projected Pell Grants from discretionary to mandatory. Beginning in 2010, the baseline includes mandatory budget authority for Pell Grants equal to the amounts that would be shown as discretionary using the BEA rules for projecting the cost of discretionary programs. The resulting outlays are also classified as mandatory. These amounts are in addition to the mandatory funding provided by the College Cost Reduction and Access Act, which provides increases in the maximum award above the appropriated level. The policy estimates reflect the baseline costs plus the expansion in benefits that is proposed by the Administration**.**

By itself, the reclassification does not increase total spending. The increase in mandatory outlays is matched by an equal reduction in the baseline level of discretionary spending. The reclassification simply makes it easier to understand the budgetary impact of the policy of increasing the maximum award and the costs associated with that increase.

Adjustments to reflect current policies.—In recent years, Congress has repeatedly extended provisions of law that have a large deficit impact or signaled its intention that a provision be extended when it enacted it for a limited number of years. The Administration's baseline assumes extension of these policies to represent the policies previously in place: continuing the 2001 and 2003 tax cuts, extending and indexing for inflation the 2009 parameters of the Alternative Minimum Tax, accounting for additional expected Medicare physician payments, continuing the Transitional Medical Assistance and Qualified Individuals programs, and continuing mandatory diabetes funding in the National Institutes of Health and the Indian Health Service.

Overseas, Disaster, and Other "Emergency" Costs.—Because the BEA baseline extends all appropriations already enacted for the year in progress, it can be subject to huge swings as a result of funding enacted as an emergency or supplemental requirement. At times, the BEA baseline extends large one-time emergency appropriations out for the next 10 years; at other times it extends very little. The current-policy baseline includes adjustments to account for these swings.

- *Overseas Contingency Operations*. Enacted 2009 supplementals are extended and inflated in the BEA baseline. However, since the enacted supplementals fund only a fraction of the 2009 costs for overseas contingency operations in Iraq and Afghanistan and other recurring international activities, the BEA baseline significantly understates those costs. To provide a better approximation of current services for these costs, the current policy baseline removes the enacted 2009 funding and inserts the 2008 full-year amounts, adjusted for inflation.

- *Non-recurring emergency costs*. The current policy baseline removes from 2010 and beyond those items designated as "emergency" requirements that are clearly one-time in nature. These appropriations include $7.5 billion for the Advanced Technology Vehicles Loan Manufacturing Loan Program, $5.8 billion for rebuilding levees in New Orleans, and $0.2 billion for the Filipino Veterans Equity Compensation Fund. There is no obvious reason that those particular one-time costs should be continued in a current-policy baseline. The Administration recognizes, however, that the baseline could be understated by including *no* one-time expenditures, which is why a final adjustment for disaster costs (described below) is included.

- *Disaster costs*. The Administration's baseline projection of current policies includes an allowance for "disaster costs." This entry represents the statistical probability that there will be major natural or man-made disasters during the remainder of 2009 and in subsequent years—major earthquakes, hurricanes, catastrophic floods, infrastructure collapses, and so on. The estimates are not a five- or 10-year historical average, but rather a representation of the small probability of very large costs. The figure is not a "reserve fund," nor is it a request for discretionary budget authority or congressional legislation of any kind.[2] Instead, it is a placeholder for potential future emergency needs. Consequently, these major disaster costs are not included in the request for $1,263 billion in discretionary budget authority.[3]

Including a placeholder for potential major disasters makes the budget totals more honest and realistic. Baselines likewise would be more meaningful if they did *not* project forward whatever disaster costs happen to have occurred in the current year. Rather, baselines should replace the projection of actual current-year costs—which might be unusually low or unusually high—with probabilistic estimates of future costs. A budget plan that omits these costs is not "calling for less spending," rather, it is unrealistically pretending that there will be no future disasters.

Pay raises and certain administrative expenses.—The baseline projection of current policy modifies the BEA baseline growth rates to remove an erroneous overstatement of the cost of the annual pay raise for Federal employees and to remove the special adjustment for caseload growth for certain social insurance programs. The BEA baseline rules presume that Federal pay raises take effect on October 1, at the start of each fiscal year, when in fact, the effective date for pay raises is now permanently set by law as the first pay period in January. This causes the BEA baseline to overstate the cost of providing a constant level of services.

The BEA baseline also adjusts the administrative expenses for certain social insurance programs by the change in the beneficiary population. There is no reason to make adjustments for a small subgroup of discretionary administrative costs when other discretionary administrative costs—and other discretionary programs providing benefits and services, as well—are not so adjusted.

[2] If a major disaster occurs, Federal assistance is likely to be granted in the form of discretionary appropriations, automatic and legislated increases in mandatory programs, and in some cases tax relief. The summary tables show the probabilistic estimate of disaster costs within the outlay totals for convenience.

[3] The request for discretionary appropriations includes amounts that can reasonably be budgeted to cover the ongoing and inevitable costs of wildfires, FEMA preparedness and response, etc.