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BUDGET ENFORCEMENT MECHANISMS

HEARING

BEFORE THE

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UNITED STATES SENATE

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WEDNESDAY, MAY 4, 2011

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:09 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Conrad, Bingaman, Carper, Cardin, Hatch, Kyl, Enzi, and Thune.

Also present: Democratic Staff: Russ Sullivan, Staff Director; Alan Cohen, Senior Budget Analyst; Tom Klouda, Professional Staff Member, Social Security; Lily Batchelder, Chief Tax Counsel; David Hughes, Tax Advisor; John Angell, Senior Advisor; Tiffany Smith, Tax Counsel; and Claire Greene, Detailee. Republican Staff: Mark Prater, Deputy Chief of Staff and Chief Tax Counsel; and Maureen McLaughlin, Detailee.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The hearing will come to order.

Confucius said, "He who does not economize will have to agonize."

Over the last decade, this country has failed to live within a budget. The debt held by the public as a percent of our total economy is now quite high, about 69 percent of the gross domestic product.

Now is the time for us to remember the warning Confucius gave. It is time to craft deficit reduction legislation that will stabilize debt held by the public by 2014 or 2015, and it should continue to reduce the deficit in the following years, as well. At the same time, the debt ceiling needs to be raised to accommodate dollars we have already spent.

As we consider a framework for major deficit reduction over time, one policy we may want to consider is a budget enforcement mechanism. How would we create a budget enforcement mechanism?

First, we could set a limit tied to a specific measure of our economy. This limit could be the level of debt held by the public or the level of Federal spending as a percent of our economy. Then, if our economy reaches that limit, it would trigger an automatic response. It could trigger an across-the-board reduction in spending, an increase in revenue or a reduction in tax expenditures, or some combination.

The trigger would encourage efforts to pass a deficit reduction package and to conclude in a timely manner. If necessary, it would make sure the deficit reduction this economy needs is accomplished.

The President has proposed a mechanism called the Debt Failsafe Trigger. Others have put forward their own proposals. One proposal put forward by Senators Corker and McCaskill would cap spending at 20.6 percent of GDP within 10 years. If the cap was breached, an automatic across-the-board spending cut would take effect.

This type of proposal presents some significant challenges. First, it would encourage domestic spending programs to be administered through the tax code, and our tax system would become even more complex.

This proposal would also cut Social Security, Medicare, and Medicaid. These cuts would have huge negative impacts on the most vulnerable Americans who count on these programs to make ends meet.

But there is a catch. If Medicare, Medicaid, and Social Security were exempted from an across-the-board cut, the cuts to other programs would be far too large to bear, and that is a significant downside to this type of trigger.

We must also consider the President's trigger proposal. His plan would place a cap on debt as a percent of GDP instead of spending as a percent of GDP. The target would be to stabilize debt as a percent of our economy by the middle of the next decade and continue reducing the debt in the years that follow.

This approach provides more tools to meet our significant fiscal challenges. It would allow us to use both revenues and spending to decrease the deficit and debt.

There is certainly a precedent for this type of trigger. President Reagan's 1984 budget included a "contingency tax" that would have only been triggered on if economic conditions reached certain levels. The proposal would have triggered a 1-percent tax surcharge on individuals and corporations, as well as an excise tax of $5 per barrel of oil. That was in President Reagan's 1984 budget.

Today we will ask how a trigger mechanism would work. In what years should the trigger be set? Should the trigger take place in just one year or are there advantages to phasing in or extending the trigger over a series of years? And how would a trigger affect our economy in an economic downturn?

In a sluggish economy, revenue slows and spending on unemployment benefits and Medicaid increases, which adds to the deficit. As a result, a trigger would slow spending to compensate.

But the worst time to be cutting spending is in an economy battling to recover, because cutting spending would deepen the economic decline. We must ensure that any trigger we consider would not worsen our economy and leave people out in the cold when they need help the most.

I look forward to taking a close look at these trigger proposals today. It is my hope that this type of proposal can help us get our deficit and debt under control so our economy can grow and create the jobs that Americans deserve.

Senator Hatch?

OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM UTAH

Senator HATCH. Thank you, Mr. Chairman. I appreciate your calling these hearings so that we can examine in detail the sources of our Nation's debt, the drivers of our annual deficits, and, of course, the fiscal challenges posed by both.

As we all know, Congress is facing a big challenge with the upcoming debate over hiking the debt ceiling. This is the third time Congress has been asked to raise the debt ceiling under this administration, once as part of the stimulus bill, twice in December of 2009, and again in February of last year—three requests to raise the debt limit from this administration in 3 years.

Obviously, the government's spending is out of control. The citizens of Utah could not be any more clear about what they want us to do. They want us to stop the spending. And I suspect that members of this committee and of the entire Senate are hearing the same from citizens and taxpayers who are tired of spending as usual.

National polling data is consistent with what I hear from Utah taxpayers. A new *USA Today/Gallup* poll shows that Americans are pessimistic about the economy and the sustainability of our Nation's fiscal trajectory. According to this poll, Americans "overwhelmingly blame too much spending for soaring Federal deficits and want to rely more on spending cuts than tax hikes to get it under control."

Well, I can certainly heartily agree with that.

Another poll from *Resurgent Republic* indicates that almost half, 47 percent, of respondents want substantial spending cuts attached to legislation that would increase the debt ceiling. That might give a glimmer of hope to those who wish to continue our current spending spree.

But they should not get too excited. The same poll showed that 35 percent opposed raising the debt ceiling altogether. Only 11 percent of voters support a clean debt ceiling hike.

Why are the people in this country demanding spending restraint? As a Nation, we are on the verge of a real fiscal crisis. The government continues to borrow money to fuel its spending habits. Spending is now trending at historic highs, 25.3 percent of GDP in the latest fiscal year.

Meanwhile, our debt is at an all-time high, and, assuming the continuation of current policy supported by both Republicans and Democrats, it is trending towards 100 percent of GDP.

And the American people get it. They understand what is causing all of this debt. The same poll from *USA Today* found that, by a margin of over 3 to 1, Americans say the deficits result from too much spending rather than too little revenue.

There is no pulling the wool over the eyes of the people on this issue, there is no spinning the people into thinking that our problem is a lack of revenue, and there is no convincing taxpayers that the solution to out-of-control spending, government spending, is that we should give the government more money to spend.

Mr. Chairman, I ask unanimous consent that a copy of both of these articles be inserted into the record.

The CHAIRMAN. Without objection.

[The articles appear in the appendix on p. 44.]

Senator HATCH. Congress would be following the will of the people if it attaches spending restraint-based fiscal reforms to the debt ceiling increase. But what will happen if, once enacted, those fiscal reforms fall prey to gimmicks, are waived or otherwise undermined?

My sense is that the people will come to this Capitol with pitchforks and torches, they will be so upset. And they would be right to do so.

Yet, if history is any guide, these reforms may ultimately leave the people betrayed and disappointed. Congress has attempted to pass meaningful legislation to control Washington spending before. First, in 1974, Congress passed the Congressional Budget Impoundment Act, which created the House and Senate Budget Committees, in addition to the Congressional Budget Office.

Eleven years later, in 1985, Congress passed the Balanced Budget and Emergency Deficit Control Act, otherwise known as the Gramm-Rudman-Hollings bill. Now, I very much appreciate Senator Gramm's willingness to come back and testify regarding this legislation today and any other wisdom that he can give us. We all know how effective he was when he was in the U.S. Senate, and I think people on both sides of the aisle have great and dear affection for Senator Gramm.

We need to make sure, though, that this time is different. Every so often, the American people make it absolutely clear to Congress that Washington needs to get spending under control, and Congress has responded. But after a few years, when the people go back to their businesses and families, Washington always returns to its big spending ways. Slowly, but surely, Congress end-runs the spending restraints the people had previously insisted upon.

Just as an example, the vaunted statutory pay-go rule was supposed to rein in deficit spending. Yet, since the enactment of statutory pay-go, the cost of end-running this rule resulted in $280 billion in additional deficit spending.

Now, this time has to be different. This time we must make meaningful and lasting reforms. We must make the fundamental changes to our spending programs that might be tough today, but that will make maintenance of budget discipline easier in the future.

The fact is we really cannot be having this debate again in another 5 years. We are already nearing a point where it is too late to enact the changes that the markets demand. And failure to act now will have a lasting detrimental impact on families, businesses, and the economy.

The markets have taken notice of Washington's profligate ways, and they are responding as you would expect. When Standard and Poor's placed the United States' AAA bond rating on a negative outlook, citing a greater than 1-in-3 chance of a downgrade within the next 2 years, that should have served as a shot across the bow of this committee and the entire Congress.

So today's hearing is both crucial and timely. No matter what happens with the debt ceiling, we need to make sure that Congress and the President stick to the fiscal reforms attached to the legislation. Both parties must accept responsibility, buckle down, and make the tough decisions, even when it hurts.

We may agree to disagree, as the President has often said, but we cannot agree to pass this debt on to our children. Doing so is irresponsible, immoral, and unacceptable.

So I look forward to hearing from our witnesses and hope that some of their recommendations can guide Congress as it moves forward in the coming weeks and months. And I want to thank each of our three witnesses this morning for being here and giving us the benefit of their good understanding.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Hatch.

I would now like to introduce our witnesses. We have a very distinguished panel today.

First—I am most honored—our first witness is a former colleague of this committee, the honorable Phil Gramm. Phil Gramm is now vice chairman of UBS Investment Bank. Phil, welcome back to this committee. We very much appreciate your intellectual insights. You are pretty far ahead of most people, and it is deeply appreciated your taking the time to be here today.

The next witness is Dr. Susan Irving. Susan is the Director for Federal Budget Analysis, Strategic Issues, at the U.S. Government Accountability Office. I might say, in passing, that Susan once worked for me. She was on my staff many years ago. I am glad to see you back again, Susan.

Finally, Dr. Paul Van de Water, senior fellow at the Center on Budget and Policy Priorities. Thank you very much, Paul, for being here, too.

Let us get going here. You know our regular order: statements in the record, summarize about 5 minutes. And I would like to try to keep all comments and the questions that we ask to about 5 minutes, too. Sometimes that slips over a little bit, but this time we are going to try to keep it pretty close to 5.

Phil, why don't you proceed?

STATEMENT OF HON. PHIL GRAMM, VICE CHAIRMAN, UBS INVESTMENT BANK, UBS AG, NEW YORK, NY

Senator GRAMM. Mr. Chairman and Senator Hatch, thank you very much for inviting me back.

In the last 9 years, I have gotten a few invitations to testify, but I have always thought there is nothing worse than an old guy who leaves who will not leave. [Laughter.] And so I have never been back in any kind of official capacity before now.

I thought this subject was so important—and it is a subject that I was very much involved in—I thought maybe I might have something to contribute. So I accepted your generous offer, and I am very honored to be here.

Today's debate is similar in some ways to the debate we had in 1985 that produced Gramm-Rudman. In other ways, the problems we face today are a lot more menacing and, obviously, are more challenging, from your point of view.

I think the deficit we face today would have been unimaginable in 1985. The economy was booming in 1985. Social Security had been reformed and would be in the black for over 30 years. We were winning the Cold War and looking forward to a huge peace dividend. And the baby-boomer retirement was something we talked about, but it was a distant happening.

Today, everything is different. We are in the most disappointing recovery of the post-war period. Baby-boomers are retiring in record numbers, driving Medicare deep into the red, and Social Security will quickly follow.

We are fighting three conflicts simultaneously. Defense spending is stretched thin. If we do not have a crisis now, I do not know how anybody will ever make a case that we have a crisis. If there ever was a circumstance that ought to sort of, in old religious terms, bring people to the foot of the cross, it seems to me that this is it.

Everybody here, except Senator Cardin, was here when Gramm-Rudman became law. We were facing a $2-trillion debt ceiling vote that seemed unimaginable at the time. Gramm-Rudman was introduced with 43 bipartisan cosponsors. It got 75 votes in the Senate, and it became law.

It was easy in 1985, as it is easy now, to criticize somebody else's proposal, and it was very hard to come up with anything that people could agree on. But one thing that people did agree on was, you could not be for nothing. It was impossible to take a position that there was not a problem, and you could be against somebody else's proposal, but you could not be against any proposal.

Doing nothing was not a tenable political option, and I think the same is true today. I think Gramm-Rudman showed, as a process, that, if you are thinking about building a 4-sided fort to deal with the deficit and pulling up the drawbridge and going back to sleep, you are going to be disappointed.

I think the best you can hope for is a mechanism that helps force action, a mechanism that encourages hard choices and compromise.

Did Gramm-Rudman work? Well, it did not balance the budget. I would say the answer is a qualified yes. Under Gramm-Rudman, the rate of growth in spending fell from 11.1 percent in 1985 to 4.7 percent in 1986 to 1.4 percent in 1987.

During the period when Gramm-Rudman was in effect, spending grew by a slower rate than any time since the 1950s. Any member of the Finance Committee will remember that we adopted a new entitlement during the Gramm-Rudman constraints, the so-called catastrophic coverage. And it was catastrophic. It was the only entitlement in American history that was ever paid for.

Now, I do not know if it was a result of the fact it was paid for—I suspect it was—people hated it, and it was repealed.

In the end, Gramm-Rudman reduced the deficit as a percentage of GDP from 5.1 percent to 2.8 percent in 1989, the year that the automatic triggers were pulled and Gramm-Rudman went out of existence.

And I want to remind you—because I am sure everybody has forgotten—under the original law, you had a bunch of triggers that, if something occurred, it was declared an emergency and various things happened. And two of those triggers were, one, if you had an armed conflict, which we had with the Iraqi war, and, two, if you had a recession, which we had in the recession of 1990. Either of those events would set aside Gramm-Rudman, and that is what happened.

I have a minute left, or am I over?

The CHAIRMAN. Go ahead.

Senator GRAMM. Looking back at Gramm-Rudman, I think there are some things that we should learn from the process, and the lessons ought to be applied to whatever you adopt now, and they are the following things.

One, having points of order in the Senate, but not in the House does not make any sense, and, if we are going to have an enforcement mechanism, it ought to require supermajority votes in both houses of Congress.

Second, we had a sequester based on estimates of CBO, but I think it is clear that you need an end-of-the-fiscal-year look-back sequester so you do not get off track. If you get too far off your glide path on deficit reduction, then the deficit becomes a threat to your process instead of your process being a threat to the deficit.

It is clear to me that the greatest weakness of Gramm-Rudman was the emergency designation. This was a weakness of Gramm-Rudman, and it was a weakness of all the follow-on procedures.

As you may remember, we once declared funding of the Census to be an emergency, even though we had taken the Census every decade for 200 years. It was an emergency because it was a Census year. The process was completely perverted. It did produce bipartisanship, and that was in cheating the system.

I think the simplest way of doing it, looking back, is just to require a 60-percent vote. If you cannot get a 60-percent vote in both houses of Congress, it is not an emergency. And trying to define what is an emergency just creates all kinds of problems.

A final couple of points. We have always used automatic spending cuts to enforce our deficit reduction mechanisms. We used them in Gramm-Rudman, we used them in the budget summit agreement. They were supported by Speaker Foley and by Majority Leader Mitchell. We used them in the pay-as-you-go process that was championed by Speaker Pelosi and Speaker Reid and signed into law by the President as part of raising the debt ceiling in February of 2010.

The logic of this enforcement mechanism is that our spending programs are a creation of Congress and they represent Congress's priorities. It was never our objective in Gramm-Rudman that the triggers be pulled. The objective was to force action, to force compromise.

I am worried about a mechanism where, if Congress and the President fail, you would have an automatic tax increase. I think that is sort of a "heads I win, tails you lose" process that would probably produce a situation where we would never reach a compromise.

I think we followed the spending procedure and law. We have never had an automatic enforcement mechanism that involved revenues, and I think for good reason.

Finally, let me conclude, Mr. Chairman—and I appreciate your indulgence—America has no guarantee that we are always going to be the richest, freest, and happiest people in the world. America is as strong as we make it or as weak as we let it become.

I think we have a crisis, and we need to act. I personally believe that passing a debt ceiling without addressing this problem is irresponsible. I do not understand, when the President supported a budget mechanism as part of the last debt ceiling increase, why that is opposed now.

Finally, if you can take action, if you can work out a compromise that reforms entitlements, controls spending, sets out a long-term concrete program, that is always preferable. Action is always preferable to process.

There are a lot of ideas out there. Senator Hatch has written many great constitutional amendments to set a balanced budget on constitutional footing. Senator Corker has made a proposal on spending. We have our experience with Gramm-Rudman.

But whatever we do, there should be two things. One, it should start now. Doing something and then not starting it until Jesus comes back creates the impression we have done something, and it actually hurts the whole process. And second, it really needs to be set out where it is binding, where it is not easy to get out of, because there is always pressure to try to get around it.

I think this is important. I think you have a lot of work to do, and I think every Congress affects the future of the country, but I think this Congress will have a bigger effect than most.

Thank you, Mr. Chairman.

[The prepared statement of Senator Gramm appears in the appendix.]

The CHAIRMAN. Thank you, Senator Gramm. I appreciate your experience and imparting that to us.

Dr. Irving, you are next. You might turn on your microphone.

STATEMENT OF DR. SUSAN J. IRVING, DIRECTOR FOR FEDERAL BUDGET ANALYSIS, STRATEGIC ISSUES, GOVERNMENT ACCOUNTABILITY OFFICE, WASHINGTON, DC

Dr. IRVING. Obviously, the panel lacks technological competence here. None of us is young, I guess. [Laughter.]

Chairman Baucus, Senator Hatch, Chairman Conrad, members of the committee, thank you very much for including me as you seek to look at ways to facilitate and then enforce decisions you make to change the long-term path of our Federal fiscal policy.

Those of you who have seen the work GAO has done over the years know that we have been—I hate to say ranting—talking about the unsustainability of the long-term outlook since we first issued long-term simulations in 1992 to members of this committee and the Budget Committee.

I would like to start with some elements of what I think process in general does for you and what is important, and then turn to enforcement, because it is in the context of process that you implement enforcement.

It will come as no surprise that I will agree, in part, and that I have a slightly different take, in part, with Senator Gramm. One of the first questions you have to address in the process in general is the time horizon.

Setting the time horizon for which you want to look at the budgetary impact of policy decisions is not just an abstract question for those of us who play in the analytic arena. If the time horizon is too short, you may have insufficient information about the long-term costs of a program.

It is not hard to design a program that saves money for 3 years and then balloons. I am old enough to remember various forms of IRAs that did that.

Similarly, it can create an artificial incentive to shift the dates of certain payments. This is one of the things that happened under early Gramm-Rudman; because of a 1-year snapshot, it was very easy to move dates. First, you move something to the next fiscal year; then next year, you move it back to the previous fiscal year. And although the snapshot looked all right, the fundamental underlying structure had not been changed.

In addition, although you have to look at both the near-term and the long-term, you should recognize that the long-term estimates are much less certain than the near-term ones. But you can know about the order of magnitude and the direction of the costs.

We know now that insurance programs can look like they are profit centers in the budget when they are not. Again, I am old enough to remember when PBGC looked like a profit center in the Federal budget.

Because all of you are confronted with more decisions and more important issues than you can possibly be asked to make in any one day, the budget structure and rules determine which decisions are surfaced for you to make, the nature of the tradeoffs. And you think of that most clearly when you look at the design of discretionary caps.

Should you separate out defense and non-defense? Should you separate out security and non-security? Should you, within the discretionary caps, distinguish between support for investment and support by consumption? Let me be clear here. I am not suggesting that investment is an excuse for more spending or borrowing. Rather, investment can be a component within an agreed-upon threshold.

Furthermore, a process should be enforceable. It should provide both for some transparency and for accountability. I think this last is especially important when you go to design enforcement. You want accountability for full costs as in the example I gave of insurance. You also want accountability for actions. Targeting enforcement to actions makes it more likely to succeed.

The first Budget Act, of course, was not aimed at getting to a particular outcome. The 1974 act was about a power shift. It was designed to give the Congress as an institution more power vis-à-vis the Executive Branch. Creating the Congressional Budget Office gave you your independent source of estimates rather than being dependent on when OMB would get around to estimating your proposal, depending on how the President felt about it. And as such, I would argue this was one of the most important shifts in power to the Legislative Branch, of which I am proud to be part.

As Senator Gramm has described, Gramm-Rudman-Hollings set targets and then used a snapshot and a sequester for enforcement.

I think it set the basis for the Budget Enforcement Act, which learned from some of the things that worked less well. For example, Gramm-Rudman held Congress accountable for results regardless of whether those results stemmed from a failure of Congress to act or from a downturn in the economy. That made it much harder to explain why you had taken hard actions when the results did not match. Similarly, the sequester did not distinguish between those areas where Congress had made tough decisions and those where it had not.

This creates an almost perfect prisoner's dilemma. Under such a structure, the worst thing in the world to be would be the only subcommittee that complied with its sub-cap. If the totals that came out of the Appropriations Committee exceeded the overall discretionary cap, the sequester was imposed on all subcommittee bills, including those that had complied with sub-caps.

I think, as Senator Gramm pointed out, no process change can force agreement where one does not exist, but it can help encourage one. It can make it easier to explain the tough choices you know you have to take, and it can help to enforce and reduce seepage.

The Budget Enforcement Act (BEA), as I mentioned, built on the lessons of Gramm-Rudman. It succeeded as far as its reach. The discretionary caps controlled appropriations; we will agree there was a little problem with emergencies, which I would be happy to discuss.

BEA sought to limit the expansion of entitlement programs—direct spending programs—and of revenue reductions, including tax expenditures. It did not seek and did not accidentally succeed in changing the path of the current structure of either tax or direct spending laws, and the problem we all face today is the need to go beyond the "stop digging." It is now time to change the path.

Now, what do I think the lessons we learned from those are? Enforcing an agreement is easier than creating one. Covering the full range of programs and activities rather than exempting large portions can strengthen the effectiveness. Targeting sequestration to areas that exceed their agreed-upon level creates better incentives than punishing everyone regardless of action. Focusing on a longer time horizon can help find a sustainable path rather than artificially shifting costs into the future. That does not mean all savings should be shifted to the future. Incorporating a provision under which Congress would periodically look back to see what the path looks like can help bring the process closer to achieving the goal.

So I would agree with Senator Gramm about the need to monitor. I would come out with a different approach.

Enforcement of discretionary spending is technically pretty easy. It is controlled through the appropriations process, and controlling congressional action is the same as controlling results.

The decisions you have to make about discretionary spending are the level of the cap and how you will design the cap. Will you set firewalls between different categories? Will you advantage some over the other?

If you select subcategories, I would strongly encourage you to target the enforcement by category. And how will you handle the necessary safety valve for something like an emergency?

You need to find some sort of definition. Periodically, one shows up in the budget resolution. But you need to figure out what it takes to enforce the definition. And I would suggest you think about for how long is something an emergency. We might all agree that massive hurricanes in August are an emergency for the fiscal year that begins less than a month from then. Is it still an emergency in 2 years? Why is spending for hurricanes or floods that occurred 3 years ago still considered an emergency? I think that you can certainly tighten that up.

For entitlements, for revenues, for spending that is run through the tax code, controlling legislative action is not the same as controlling results. Even if you could come up with caps, they will not change the underlying structure of the gap between revenues and the spending that goes on automatic pilot.

In a way, what you need is a set of targets that puts you on a downward path. Then measure success on specific goals for that downward path based on estimates as you go.

One approach would be to select a debt-to-GDP goal, not for each year, but for 5 or 6 or 10 years from now, and then set a path in the form of either spending targets or something else that is measurable and enforceable.

Ideally, in the first year or two you would enact the legislation that leads to achieving the goal. You do not want to be coming back every year unless you have to make adjustments. And then you would monitor progress along the path, because, if it slips either because of the economy or because we have several Katrinas, heaven help us, you could decide to adjust the date at which you achieve your goal by enacting a new wedge-shaped policy.

What do I think, in general, you need to pay attention to in designing enforcement and penalties? It should be painful enough that it is not an attractive option. You do not want people to say, "Oh, instead of taking the hard cuts, I would rather say 'the guillotine made me do it.' "

The goal is to encourage action. So the penalty or enforcement mechanism should not be perfectly designed to be an answer you could all live with easily. It should be tied to actions so as to avoid perverse incentives, and it should not be so draconian that it is not convincing. I think this is the point the Senator made when he talked about, when it gets totally out of hand, it is not convincing. You all, unfortunately, have some experiences with that every year vis-à-vis the SGR adjustments.

Finally, because this is something I have spent a great deal of time on, I would like to say something about the debt limit. The debt limit is widely misunderstood to be a policy tool when it is not currently designed to be one.

The debt limit is not a credit limit. The debt limit reflects the spending and tax decisions that all of you and your colleagues, with whichever president was in office, have jointly made in the past. It is not like the limit on your credit card. It is more the question of whether you will pay the bills you have already charged.

To use the debt limit as a policy tool would require tackling the debt limit at the time spending and revenue laws are enacted. Congress did this 3 times in the last several years with the Emergency Economic Stabilization Act of 2008, with the Housing and Economic Recovery Act of 2008, and with the American Recovery and Reinvestment Act of 2009. It raised the debt limit to match the spending or revenue cut, i.e. the increase in debt estimated to come from that piece of legislation. That is to say, you and your colleagues and President Bush and then President Obama recognized that you were enacting legislation that led to an increase in debt.

You could use the debt limit as a tool in advance, but right now, it is a weakness in our fiscal regime that it comes after the fact. If H.R. 1 had become law in January, you would still be hitting the debt limit this spring.

I stand more than happy to answer any questions and, of course—as part of an agency that works for you all—to help any of you as you go on designing this proposal.

And thank you for your indulgence on my time.

[The prepared statement of Dr. Irving appears in the appendix.]

Senator HATCH [presiding]. Thank you.

Dr. Van de Water, we will take your testimony.

STATEMENT OF DR. PAUL N. VAN de WATER, SENIOR FELLOW, CENTER ON BUDGET AND POLICY PRIORITIES, WASHINGTON, DC

Dr. VAN DE WATER. Senator Hatch, members of the committee, I appreciate the opportunity to be here with you this morning.

The Balanced Budget Act of 1985, known as Gramm-Rudman-Hollings, set annual deficit targets and imposed automatic spending cuts if the targets were expected to be missed.

The deficit targets proved unrealistic and unachievable, however. They were modified in 1987 and effectively repealed in 1990.

Gramm-Rudman was originally supposed to balance the budget by 1991, but the actual deficit in that year amounted to 4.5 percent of GDP, the equivalent of nearly $700 billion in today's terms.

The Budget Enforcement Act of 1990 replaced fixed deficit targets with a process designed to enforce compliance with the deficit reduction measures agreed to at the 1990 budget summit. The BEA established caps on discretionary spending and a pay-as-you-go requirement affecting mandatory spending or revenues such that they not add to the deficit.

These procedures were backstopped by automatic spending cuts that applied to precisely the same programs specified in Gramm-Rudman. Unlike Gramm-Rudman, however, the BEA proved successful.

Based on this experience, most observers have concluded that budget procedures are much better at enforcing deficit reduction agreements, as the BEA did, than at forcing such agreements to be reached, as the Gramm-Rudman legislation attempted to do.

Nonetheless, proposals were again surfacing to change the budget process in an effort to force deficit reduction. For example, S. 245, introduced by Senator Corker, would limit Federal spending to 20.6 percent of GDP, the average from 1970 through 2008.

The bill would impose automatic across-the-board cuts to close any gap between projected spending and the cap. If the required spending cuts were achieved solely through this mechanism, they would total about $1.3 trillion in Social Security, $860 billion in Medicare, and $550 billion in Medicaid over the cap's first 9 years.

Other proposals, such as S.J. Res. 10, would limit spending to even lower levels and would have even more severe consequences.

Placing such a cap on total spending would essentially absolve revenues, including tax expenditures, from playing any part in the effort to bring long-term deficits under control. In fact, it would encourage the conversion of spending programs into tax expenditures, which would not count against the cap. And it would favor subsidies provided through the tax code, which generally favor corporations and high-income individuals, over other forms of assistance which primarily benefit low- and moderate-income people.

Former Senator Pete Domenici and former OMB Director Alice Rivlin recently proposed a more promising process that they call save-as-you-go, or SAVEGO. SAVEGO expands on the 1990 budget enforcement procedures in a way intended to prompt policymakers to agree on the changes necessary to put the Federal budget on a sustainable path.

Under SAVEGO, the President and Congress would establish a debt-to-GDP target and a path to achieve it. Then the debt stabilization path would be translated into annual deficit reduction amounts for separate categories of spending and revenues.

If Congress failed to achieve the necessary savings, SAVEGO would impose automatic spending cuts and reductions in tax expenditures or other revenue increases within each category.

A plus of SAVEGO is that it would require specific amounts of savings which are under the direct control of policymakers rather than setting deficit or debt targets, which, as Ms. Irving said, shift when the economy or other factors change.

It thereby avoids harming the economy by requiring larger budget cuts or tax increases when the economy weakens, and it does not interfere with automatic stabilizers, such as unemployment insurance and food stamps.

Another positive aspect of SAVEGO is that its automatic changes would affect both spending and revenues. If an automatic mechanism only affected mandatory spending programs, but not revenues, reaching a deficit reduction agreement would become less likely since opponents of an agreement that included revenues could achieve their goal simply by sitting on their hands.

Some argue, as Senator Gramm has, that since previous budget enforcement mechanisms did not involve automatic tax changes, automatic tax changes are not needed today. But new circumstances demand new approaches.

First, the budgetary situation is different. Today's budget problem, as both of the previous witnesses have said, is worse than that of the 1980s, and we cannot afford to ignore half of the budget in devising solutions.

Second, the political environment is different. In the 1980s, President Reagan was seeking large increases in the defense budget, and requiring the defense budget to bear half of any automatic cuts kept the President's feet to the fire.

Today, automatic tax changes must play the role that automatic defense cuts played in the 1980s.

One problem with the SAVEGO proposal is that it does not provide for the exemption of low-income programs from sequestration, as has been the case under Gramm-Rudman and every one of its successors.

It is essential that these exemptions be maintained in any new budget enforcement legislation.

As many of our Nation's religious leaders have recently reminded us, the Nation needs to substantially reduce future deficits, but not at the expense of hungry and poor people.

And the success of pay-go during the 1990s demonstrates that exempting low-income programs from sequestration does not weaken the enforcement mechanism.

This concludes my remarks, Mr. Chairman. Thank you very much.

[The prepared statement of Dr. Van de Water appears in the appendix.]

The CHAIRMAN. Thank you, everybody.

One question that is kind of popping around here is, with any trigger, should spending and revenue both be included or just spending? Some say both.

I would like your views. All three have spoken a bit on that subject, but let me just go down the table, and I will start left to right.

Dr. Van de Water, you said that revenue should be included. But if we had a trigger and, say, it is debt as a percent of GDP, that, by some definition, might automatically include revenue.

But the deeper question is, should revenue be included in any trigger?

Dr. VAN DE WATER. Well, I have made my position, as you have said, Mr. Chairman, quite clear——

The CHAIRMAN. Say it again.

Dr. VAN DE WATER [continuing]. In both my prepared remarks and my oral statement.

But just to make two brief additions. First of all, as you correctly suggested in posing your question, there is, of course, a distinction between the automatic enforcement mechanism, on the one hand, which I think all three of us have said should be the last resort.

Senator Gramm said, and I wrote this down, "Action is always preferable to process." I certainly agree fully with that statement. And, of course, if you, the Congress, are trying to reduce the deficit, revenues are always an option in that sense, even if not included in the enforcement mechanism.

But I do think it is important that they be included in the enforcement mechanism for precisely the reason I gave; namely, if you are trying to bring groups with disparate views to the table, the enforcement mechanism has to threaten some action that both groups find unpleasant, and it is not necessarily going to be the same thing for both sides.

As I pointed out, in the 1980s, President Reagan found automatic defense cuts as being very unattractive, and that was the mechanism that was decided upon at that time to make sure that his side was brought to the table.

The CHAIRMAN. My time is expiring.

Quickly here, Dr. Irving, your point, your thoughts.

Dr. IRVING. I guess in order to conserve your time, I will just say, yes, I think that you need to include revenues and spending in the trigger, in the enforcement mechanism and their design options.

The CHAIRMAN. Why revenue? Some think no revenue. Why do you think revenue?

Dr. IRVING. First of all, I think that the problem is too large, that it cannot be solved without dealing with both sides. Analytically, you cannot raise taxes fast enough, even if people were to agree with it. And I do not think the American people are prepared to give up enough of what they currently get from government to settle on 18 percent of GDP, which is the historical average.

As a result, I think, both for the reasons Paul mentioned and because if you have settled on a design and a program, you want the enforcement to also be 2-sided.

Also, I think it is a mistake to pretend that spending is just a group of politicians spending money against the will of the people, and tax cuts are always wonderful. It has been my experience when I travel—and I do not deal with constituents the way you all do, but I get lots of phone calls, and I do travel—that everybody is in favor of small government until they are not.

Everybody hates big government, but have you seen the polls? What they want to cut is foreign aid, and they want to cut it to 10 percent of the budget when it is currently 1 percent.

People believe in emergency assistance—when the States have a natural disaster, they dial area code 202. People turn to their Federal Government for a great many things, sir.

The CHAIRMAN. Senator Gramm?

Senator GRAMM. Well, Mr. Chairman, I think people are confusing what they want the outcome to be with the enforcement mechanism.

I think we have never had automatic tax increases because the whole concept of setting up a structure where government fails and people's taxes go up, is simply not workable. And what I am concerned about is, if we want to prejudge what we want the outcome to be or what some people want the outcome to be in the enforcement mechanism, then we are just setting up a blind formula to do our work.

If Congress wants to raise taxes, it ought to do it. If it does not, it should not. If it wants to cut spending, it should do that. But the idea of having an automatic mechanism that is going to raise taxes if Congress and the President fail to get the job done is a nonstarter with the public, and I think it is sort of a pernicious provision that will induce some people to say, "Well, let us just do nothing and let this formula make the hard choices." And as you said, you would end up with a nightmare of a tax code.

The CHAIRMAN. So, basically, your thought is, do not include revenue because the public does not want it.

Senator GRAMM. Well, the public does not want it. It does not make sense. Spending programs are a creation of Congress. They represent Congress's priorities, and they are a forcing action if you cannot—if you write the mechanism so that you cannot get out of it by cheating or by finding a way around it, then I believe you will force action.

The CHAIRMAN. Some think that tax expenditures are spending created by Congress.

Senator GRAMM. I think it depends on how you view it. I think if you lower the amount that people can deduct on mortgage interest on their home and their taxes go up, they see it as a tax increase.

I am not saying that they should not be looked at. I think they should be looked at, and I think we should dramatically reduce them and lower rates, both corporate and individual rates. But the idea of having a mechanism where, if government fails, the taxpayer pays, just sounds alien to our process, to me.

The CHAIRMAN. Senator Hatch?

Senator HATCH. Thank you, Mr. Chairman.

Senator Gramm, you are currently a vice chairman of the investment banking division of UBS Bank. Now, we hear so often about the "catastrophic" events that would occur if the U.S. were to reach the debt limit of $14.3 trillion later this year.

Now, Secretary Geithner notified us earlier this week that he could potentially hold off until August before raising the limit as required.

Now, I am interested in your perspective regarding the international community, since they are one of the primary holders of our debt.

Senator GRAMM. Well, Senator Hatch, I visit with People's Bank of China, the Bank of Japan, and the Bank of Korea at least 3 times a year each, and, needless to say, when I visit with them, the topic is finance, the value of the dollar, the Federal deficit, the strength of the American economy.

These three institutions are the largest holders of dollar-denominated assets in the world, and most of them are Treasury notes and bills. I have never had any one of those three banks ask me about the debt ceiling.

They are very concerned about the value of the dollar. They are very concerned about inflation. They are very concerned about the deficit and the debt. But to the degree that they are concerned about the debt ceiling, no one has ever asked me a question about it.

I think that what we have done here is we have this specter of the world coming to an end which has been created out of this silly notion that Congress is going to pass a clean debt ceiling, when, under President Obama, last year, they could not pass a clean debt ceiling when the President's party controlled vast majorities in both houses of Congress.

So it is not going to happen. I think that is clear.

Do I think we should pass a debt ceiling? Yes. And I think the sooner we could work out a compromise as to what we are going to do to deal with the deficit and pass it, the better off we would be.

But this holding out the specter that the world is coming to an end I think is a gross overstatement. I do not think Congress would want the President to have the powers he would have if we did not pass a debt ceiling. He could cut spending in areas he wanted to, spend in areas he wanted to.

You have lots of legislation, much of it going back to the Civil War, that gives the President vast powers.

So let me restate my position so it is clear what I am saying. I think we need to pass a debt ceiling. I think it is like the bill collectors at the door. The credit card analogy is a good one, but that is not where it stops with real families. They pay their bills, but they get the credit cards, they get the butcher knife, they sit down at the kitchen table and they cut up the credit cards, and I think that is what we ought to do on this debt ceiling.

I do not think we ought to be frightened out of taking action that needs to be taken. The danger to America is much greater if we do nothing than it is if we simply raise the debt ceiling.

Senator HATCH. All right. Now, you were a key player in the Senate fiscal battles around here for almost a couple of decades.

The fundamental question I have for you is, how do we get a bipartisan deficit reduction deal to stick once the ink from the President's pen dries?

Senator GRAMM. Say that one more time, Senator.

Senator HATCH. Well, if we can get a bipartisan deficit reduction deal put together, how do we get it to last, to stick?

Senator GRAMM. Well, you know, that has always been the problem when we have had deals in the past. The taxes stick in many cases. We do not live up to the spending end of the bargain.

That lack of credibility is one of our problems in doing something. But I think what Congress has to do is get its game face on, that there really is a crisis, and it is amazing, when you decide you have to do something, what you are capable of doing.

And I will just give you an example. Everybody knows that we are going to have to do something about Social Security. When Social Security was created, the average American did not live to be 65. Now, the average time that people are living is in the high 70s for men and the 80s for women.

We are going to have to raise the retirement age. We are already doing it to 67. We ought to do it to 70, and everybody knows it.

There was no cost of living increase under Social Security. Now, we index by the wage rate, which is a multiple of inflation. If we just went back to inflation, we would have a big impact.

Those two changes would eliminate long-term actuarial imbalance. And then we need to look at means testing these programs and Medicare.

Senator HATCH. Well, right now, this committee is examining the issues around tax reform, and, after the grand bargain in 1986, my friends on the other side were pining for broad-based tax increases.

The same thing happened after the Andrews Air Force Base deal of 1990, and they got them in the 1993 Clinton tax hike bill.

On the other side of the ledger, after the bipartisan deal of 1997, my friends on the other side were pushing to break the appropriations spending caps of that deal.

And I guess the question I have is, how can we ever be assured that a deal is a deal? This is something that worries me.

Senator GRAMM. Well, I think you have to—whatever you do, you have to do it all at the same time. You cannot say, well, we are going to make these decisions in the future, but we are making these decisions now.

I think you have to set out multiyear appropriations. You have to reform entitlements. You have to have some enforcement mechanism. And I think our problems in the past represent an impediment, but this is such a big crisis. I think we have to find ways to get around that and to develop some trust.

Senator HATCH. My time is up, Mr. Chairman, and I am sorry I took so long.

The CHAIRMAN. Thank you, Senator Hatch.

Next, Senator Bingaman.

Senator BINGAMAN. Let me just ask, Dr. Van de Water, you talked about the SAVEGO, save-as-you-go proposal, that Senator Domenici and Alice Rivlin proposed as a debt-to-GDP target, establishing a debt-to-GDP target.

That is very different than what Senators Corker and McCaskill have proposed, where it is a spending-to-GDP target, as I understand it.

Could you just describe the merits or demerits of those two models? If we were to set a target, should it be based on debt-to-GDP rather than spending-to-GDP, in your opinion?

Dr. VAN DE WATER. Yes, Senator Bingaman, I do think that focusing on debt or deficit is the right thing to do.

Obviously, we have deficits because spending exceeds revenue, and deficits can be reduced either through reining in spending or increasing revenues.

In fact, given the magnitude of the problem, at least Dr. Irving and I both feel that it is necessary to look at both sides of the ledger, that the problem is too big to be solved just through spending reductions, particularly given the continued increase in health care costs.

The growth in costs was reined in significantly in public programs and Medicare through the Affordable Care Act, but it is a problem that is not affecting just public programs, but health care spending generally.

Also, as Senator Gramm just referred to, we are now in the first phases of the retirement of the baby-boom generation, which is going to be driving up spending for Social Security, Medicare, and Medicaid by several percentage points of GDP in coming years.

So, given our current situation, I think it would be much preferable to focus on deficit and debit rather than simply one side of the budget ledger.

Senator BINGAMAN. Dr. Irving, I gather from your comments, you basically agree that that is a more appropriate way to structure any kind of long-term deficit reduction plan; is that right?

Dr. IRVING. Yes, sir.

Senator BINGAMAN. Senator Gramm, let me ask you on that narrow issue. I know you are not in favor of any automatic enforcement by way of a tax increase. I have understood that. But do you think it would make more sense to have a target, whatever target is arrived at, be done in terms of debt-to-GDP rather than particular spending levels to GDP?

Senator GRAMM. I used to dream of us paying off the debt. Boy, that dream is a long way from any kind of reality today.

You can do it either way. I think it probably makes better sense to do spending or deficits, but you can make it work either way.

And I just would say—not to beat a dead horse—on the automatic tax increase issue, that we are still—what is the best way to deal with the deficit may be one thing, but what kind of automatic mechanism you want to use to force it I think is another thing.

And I never was in favor of an automatic cut. I always worked to try to come up with a compromise. And the strength of it was that you could say, I hate doing what I am doing, but I do not hate it as much as just this senseless across-the-board cut. It was a shield, as well as a forcing mechanism.

But I am just afraid, if you have automatic tax increases, that that could actually encourage people to let this mindless process work, and I think that would have a pernicious effect on the whole process, is my thinking.

Senator BINGAMAN. Any others have thoughts on that last point?

Dr. IRVING. Senator, I think, as I indicated, that you want the enforcement to be unpleasant enough that people wish to avoid it. I do not share the view that the public hates all the spending programs. I think the reason we are in this situation is that, in general, people love spending and hate paying for it.

I am not sure I see any difference between an automatic surtax or other tax enforcement being a statement of failure rather than an automatic spending cut.

Both of them are statements about the fact that Congress was unable to reach agreement on enacting legislation with the President and that it failed to achieve the target it had set for itself.

So it seems to me, the triggering of any automatic procedure is a statement of a kind of failure, and it should look, as I say, plausible, but not be perfectly designed to be a good alternative.

Senator BINGAMAN. Thank you.

The CHAIRMAN. Thank you, Senator.

Senator Cardin?

Senator CARDIN. Thank you, Mr. Chairman. And let me thank all of our witnesses.

Dr. Irving, I agree with you that the debt ceiling is not the right vehicle that we should be using. The debt ceiling should be handled with the recognition that it is the completion of prior decisions that have been made.

But we are looking at a debt enforcement mechanism that will be most likely considered in conjunction with the debt ceiling issue.

I do have two concerns that have already been raised. Federal fiscal policy has to have the tools necessary to deal with our economy. The Federal Government can deal with our economy.

Many of the approaches used to reinvigorate the economy are countercyclical, and that needs to be built into any enforcement mechanisms.

The second concern is about the most vulnerable Americans. When you take a look at enforcement mechanisms, particularly in this current political climate, it is unclear whether we will have the same sensitivity that was demonstrated with Gramm-Rudman and with the balanced budget enforcement mechanisms to recognize that there are certain programs that need to be given special consideration.

Now, I want to focus on the first question the chairman asked, regarding tax and revenue issues. I listened very carefully to Senator Gramm's comments, and I also listened to Dr. Van de Water's comments. And it seems to me that you are in a committee that is probably friendlier towards Senator Gramm at this particular moment because it is the Finance Committee, and the Finance Committee is the committee that has general jurisdiction over many of the tax expenditures.

But if we had appropriators here, they may have a different view on this. And it seems to me that, if we are going to get budget discipline, we have to recognize the realities that, in today's world, the tax expenditures are, in many cases, very similar to appropriations bills.

We use the tax code to advance our energy policies. We use the tax code to advance our housing policies. We use the tax code to advance our health policies. And the list goes on and on.

So I am not sure I understand the distinction, Senator Gramm, that you raised as to why the enforcement mechanism, if it is going to be real, should not put pressure on the tax expenditure side and why it should only be limited to the appropriations side, whether it is by the annual appropriations bills or mandatory spending.

I underscore this by saying that, if we are going to have enforcement, it seems to me, if the enforcement is going to require us to act, then—and I agree with you. I do not want to see the trigger pulled. I like to see action.

You made a comment that you thought if revenues were in there, it would make it less likely that we would act. It seems to me it makes it more likely that we would act, because it makes it even more challenging for how the across-the-board will affect the political environment that we all live in.

Senator GRAMM. Let me respond that I see a difference between money that the American worker has and money that government is spending.

Now, it is true that we let working families deduct their mortgage interest payments on their home from their taxes, and it is true that that is a tax expenditure.

It is also true that I would be willing to get rid of every tax expenditure and just cut rates. I am no big defender of so-called tax expenditures.

But to suggest to working families that, if we do not get our job done, if you do not get your job done, if the President and the Congress cannot work out some way to deal with this problem, that part of the solution is going to be taking money away from them—and I am glad you are going to be trying to sell that and not me——

Senator CARDIN. Well, I have a hard time selling——

Senator GRAMM [continuing]. Because I just do not think it makes any sense.

Senator CARDIN. I am going to have a hard time with students telling them that these across-the-board cuts are going to take money away from their aid programs or that in health care, that the health centers are going to have to reduce the number of people who can receive treatment. I can go down the list of who is impacted by across-the-board cuts, and I could not agree with you more, I never want to see that happen.

I want to see us act, and I think the trigger mechanisms are there to force us to act. But I must tell you, I differ with you. I think tax expenditures are more focused toward higher-income families than the across-the-board impact of the budget expenditure cuts.

Higher-income people are more likely to take advantage of tax expenditures than lower- and middle-income families.

So, from the point of view of equity, I would take exception. From a political standpoint, you might be right, and that is why I think including tax expenditures makes it more likely that Congress would prevent the triggers from taking effect.

Senator GRAMM. I would just say—and then I am going to be quiet on this subject—but I would just say that it would be one thing if you cut these deductions as part of a budget agreement and you voted on it and it was debated, but I think it is quite another thing when it just happens automatically, and it happens because of a failure in the government.

And, again, I understand that you have all these people who are beneficiaries of various parts of the tax code, but they view it that they are already paying taxes. Forty-nine percent of the people pay all the taxes in the country, and the idea of raising their taxes more if government does not do its job, in essence, so spending can be higher, maybe as part of a budget deal that deals with the crisis, you could sell it, but as an automatic process, I do not think so.

Senator CARDIN. The spending will not be higher, because the automatic reductions will be primarily on the spending side. So spending is going to take the largest hit.

The use of automatic reductions represents a failure. We all recognize that. The goal here is to prevent the triggers from being exercised. As a matter of fairness and a matter of effectiveness, you get more likely results by making it comprehensive.

The CHAIRMAN. Senator Enzi?

Senator ENZI. Thank you, Mr. Chairman. And I am not going to get into a debate with any one of the three. I really appreciate the comments that you have made, but, Senator Gramm, I have so much missed your ability to debate on the fly and to phrase quickly and to explain in simple, but very forceful words.

And I appreciate the testimony that all three of you are giving today, but as I say, I have missed the kind of testimony and debate that you do.

Senator GRAMM. Well, thank you, Senator.

Senator ENZI. And I appreciate the comments that you made. Now, both you and Dr. Irving mentioned look-back sequester. Could you tell me a little bit more how a look-back sequester would work?

Senator GRAMM. Yes. I did not go through Gramm-Rudman because I knew I was going to have a time problem, but basically, when the OMB does its snapshot of where we are in terms of the deficit, that is where the sequester occurred, if one was due, given a failure to meet the target.

But then, at the end of the fiscal year, things often change. Almost every State government which has a constitutionally required balanced budget has a look-back process where, at the end of the year, they have to make these final adjustments.

I think that is critical because, if you let things change and the deficit gets too big, then your process is no longer credible, and that is why this look-back process is so critical.

It is why dealing with the emergency designation, which was totally abused under the old system, and why having real points of order that keep the process in place unless there really is such an upheaval and convulsion that Congress is willing to stand up and repeal it, are critically important.

It is worse to do a process that really has no effect than it is to do nothing, because then you mislead people.

Senator ENZI. Thank you.

Dr. Irving?

Dr. IRVING. Senator, thank you for giving me a chance to clarify, because I was not so much talking about a sequester as much as a process.

Imagine a package where you set a target that is several years out and then you set a path to that target. You would do your enforcement based on actions that the Congress takes.

So if Congress, in year one, enacts legislation with discretionary spending, direct spending, limits on tax expenditures, revenues, that together as a package meet that multiyear path to achieve that debt-to-GDP target or whatever target you pick, no enforcement would be triggered that year, because you would have done what you had to do.

On the other hand, there are automatic stabilizers in the Federal budget. That is, revenues drop when we have a recession. So, at the end of the year, I would recommend looking back and asking, "Did something happen to push us off the path we thought we enacted?" If it happened because the U.S. went into another deep recession, you would not want to recoup the slippage right away, but Congress should have to explicitly decide on what path it wants to take to recoup that slippage.

That is, "Now it looks like we do not get to the debt/GDP ratio of X percent in 2020 unless we do more; today we are going to enact some more things that kick in in 6 months or a year from today to get us back on that path," so that the enforcement is always tied to the actions, but you do not let things like the economy or the floods or whatever just mean, "Oh well, too bad, we did not make it."

And you get yourself back on the path on some reasonable basis. That also means you do not have to overturn the automatic stabilizers, because, regardless of whether you want to actively initiate countercyclical bills, presumably you do not want to overturn the automatic countercyclical nature of the Federal budget.

Senator ENZI. Thank you.

Senator Gramm, what do you think about this sequester package being over a period of years with a readjustment, and how detailed do you think that we ought to be?

Senator GRAMM. Well, you know the debate about, do you want to set out a program where people know what it is versus one that can adjust based on what is happening in the economy, is an old debate.

I would have to say, given our experience in the last 3 years under both President Bush and President Obama, that the idea of stimulating the economy by spending money has pretty well been discredited.

You might not think so.

Dr. IRVING. But I did not say adding stimulus. I just said you might not want to overturn the automatic stabilizers.

Senator GRAMM. I think you are better off, within limits, to have fixed targets. I think, as strange as it sounds, given the magnitude of our problems today, you probably need a 10-year program to bring the deficit under control, if you are really going to enforce these targets.

And the important thing to the economy, the important thing to investors, is not that you are going to do it tomorrow. It is that you are going to do it. And, if you get a credible process, you are going to get immense credit in the market. You are going to affect investment, you are going to affect equity values based on the credibility of your program.

But the deficit is so big now that, to have a credible program you could really enforce would probably be about a 10-year program.

Senator ENZI. Thank you. My time has expired.

The CHAIRMAN. Thank you.

Next, Senator Carper.

Senator CARPER. Thank you.

Senator Gramm, nice to see you.

Senator GRAMM. Nice to see you.

Senator CARPER. Welcome back.

Senator GRAMM. Thank you.

Senator CARPER. And our two other witnesses, very nice of you to come and join us today.

There is a fair amount of discussion in here today about two primary ways to reduce deficits, and one of those is to cut spending, and the other is to raise taxes. And I want us to focus for a little bit today, move a little bit off of topic actually, but it still relates to deficit reduction, but I think there are two other ways that deserve not just our attention, but our action.

And one of those is to make sure that we are growing the economy and to make sure that we are actually heeding the advice of a guy named John Chambers, who is the CEO of Cisco.

He likes to say that the jobs in the 21st century are going to go to States or to nations that do two things especially well. One of those is to create a world-class workforce; second is to create a world-class infrastructure, broadly defined.

I would add to that a third one—actually, the President added a third one in his State of the Union address—and that is to make sure that we are making smart investments, not just the government, but as a Nation, smart investments in R&D that has commercial application so we can innovate and come up with products and technologies that we can build here in the United States and sell around the world.

The President likes to say that if we are going to win the 21st century, we are going to have to out-educate, out-innovate, outcompete everybody else, and I think he is on the right track.

My question of the three of you today is actually the kind of R&D investments you think make most sense. And, if you all could do that just very briefly, please, and then I will have one other question. I want to talk a little bit about culture and thrift, creating a culture of thrift to replace the culture of the spendthrift in our Nation's Federal Government.

So, do you want to go first, Senator Gramm?

Senator GRAMM. Let me try to be brief, because you want to give everybody a chance to answer. I think the investment that makes the most sense is private investment, and I think any way we can find to encourage private investment, we want to do it.

I would strongly commend to the committee, having spent 9 years working all over the world and working with a lot of American companies, we need to do something about the corporate tax rate, and how wonderful it would be to have a markup where you just eliminate all the deductions, lower the rate, and then, if somebody wants to put it back, they have to debate it and they have to get a vote on it.

This corporate tax rate is really doing us a lot of harm. It is inducing people to invest abroad. It is inducing people not to bring the money back. Countries all over the world have cut it, and we are at a terrible disadvantage.

I think deficit reduction that is credible will encourage private investment. There have been some ideas out there related to infrastructure. My colleague at UBS, Robert Wolf, wrote an article in the *Wall Street Journal* about an infrastructure bank. He testified on the subject. And unlike a lot of people who are proposing basically to create another government agency that will give grants and stuff, his conception is about an institution that actually makes loans, operates at a profit, and I think that is the only kind of approach that would have any chance of being adopted or working.

So, again, private investment is better because it is more likely to be successful over the long term.

Senator CARPER. Dr. Irving?

Dr. IRVING. Senator Carper, I am not about to pick a type of R&D, but one of the things we have suggested in the past is that, within whatever level of discretionary cap you select, you might wish to pay attention to the allocation between support for consumption and a fairly strict definition of investment, which we limited to R&D infrastructure and education and training.

It is worth noting, of course, that the deficit is a kind of disinvestment by the Federal Government.

Senator CARPER. Thank you.

Dr. Van de Water?

Dr. VAN DE WATER. Thank you, Senator. Like Dr. Irving, I am not going to get into areas where I do not have a lot of expertise, but I think just two points.

One, I would agree with Senator Gramm on part of his point on the corporate tax rate. We were discussing tax expenditures earlier. This is one area where there are a lot of tax expenditures, and, clearly, most economists would agree that it would be better to get rid of a lot of the tax preferences in the corporate tax structure and have lower marginal rates.

The only point where I would at least modestly disagree is that, while private investment is obviously very good, there are areas where private investment is just not going to take place and where the Federal Government needs to step in.

For example, Pell grants for low-income students: that is not going to be done by the private sector; highways, other aspects of transportation, are public responsibility. And, of course, there are forms of basic research which are clearly a public good, and they are not going to take place privately.

Senator CARPER. All right. Those are good points. Thanks a lot. And my time has expired. Let me just close by making this observation.

I think everything I do, I can do better. My guess is everybody in this room, all of us, everything we do, we can probably do better. The same is true of the Federal Government, and one of the things I have been encouraging all of us to do, Executive Branch, Legislative Branch, is to look at almost every program, every nook and cranny of the Federal Government, and ask this question: Is it possible for us to get better results for less money or better results for the same amount of money?

And you take what some would describe as a culture of spendthrift in our Federal Government and replace it with a culture of thrift; not just for a day, not just for a week, but really as sort of a permanent change of mind.

Thanks, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Thune?

Senator THUNE. Thank you, Mr. Chairman. And I want to thank our panel.

Senator Gramm, welcome back. I was a staffer here when Gramm-Rudman-Hollings passed and——

The CHAIRMAN. Where were you? Where did you work?

Senator THUNE. Jim Abdnor, back in 1985. But I remember explaining it as I would travel with my boss across South Dakota.

But it was a very effective mechanism for some time until it got overtaken by subsequent congressional action, I think because the decisions became so hard.

But it strikes me that we have to have some kind of an imposed discipline. There has to be an enforcement mechanism, because Congress has not demonstrated in the past the capacity or at least the will to make these hard decisions and these hard choices.

And so I appreciate your perspectives on some of these various ideas that are circulating out there.

I would like to direct, if I could, a question to Senator Gramm or Dr. Irving. Both of you have mentioned troubles with emergency spending designations and their effect on spending, and I wonder if maybe you could discuss further the need to have some sort of a supermajority in both the House and the Senate to approve any emergency spending, because it strikes me that, whenever there is a desire to spend money around here, we just declare it an emergency and we operate outside any kind of budgetary parameters that might exist.

Senator GRAMM. Well, let me say, when we wrote Gramm-Rudman, there was substantial concern about it, there was substantial opposition. So it had all kinds of emergency provisions in it. And, as I said earlier, we even declared the Census as an emergency at one point during the process, even though we have done it every 10 years for 200 years at that point. And we could hardly say it was an emergency.

I think the only real way to measure an emergency is, can you get a supermajority vote? If you cannot, you do not have an emergency.

And I think given our experience with Gramm-Rudman—and congratulations on your proposal that tries to bring several different ideas together. If you cannot get a supermajority vote, you do not have an emergency.

And I think, rather than trying to define an emergency so that people can then take the definition and figure out how to get around it, I think simply requiring both houses of Congress to have a supermajority vote to declare an emergency as it relates to each individual violation is the right way to go.

Senator THUNE. Dr. Irving, anything to add to that?

Dr. IRVING. Senator, I am not the world's biggest fan of supermajorities. I vividly remember, but cannot cite in detail, an article Norman Ornstein once wrote pointing out that sometimes supermajorities end up expanding exceptions; if you have more than 50 notes, but not quite two-thirds, what is the price of additional support? Those are his words, not mine.

I am not convinced that there are very many things that you could not get a supermajority for by adding enough things.

So what I have been worried about in the past in emergency spending is what I call hitchhikers; that is, flood relief or something on which everybody agrees—it would not even be hard to get 100 percent agreement that it is an emergency, but the way we budget for emergencies in the basic budget does not allow room for them. Then suddenly you have something that gets added which is not an emergency and does not even get designated as one, but gets to ride through with less scrutiny.

I worry about those. I worry a lot, as I said, I think before you arrived, about the time horizon on an emergency. For how many years is a flood still an emergency?

I think we should think about fundamentally changing what we put in the budget for emergencies. It is a 5-year rolling average, but we take anything bigger than $500 million out of the average. It might be that the world is changing enough where that is too low a threshold. Also you would want to fence that money so that it is only available for emergencies and is not just a fund.

But in the end, you can only enforce things that people are willing to enforce. The advantage of the definitions people have attempted to use in the past was they could serve as a kind of speed bump. Even if you have to stand up and explain why a proposal met that definition and you have to have a roll call vote, it will not work if you are determined to overturn it. But if there is a desire to limit it, it may help.

That is not a very satisfactory answer, I realize.

Senator THUNE. You had mentioned in your remarks too the insurance programs that often look like moneymakers in the short-term, but then end up in the long-term being unsustainable.

Could you discuss that observation as it relates to the CLASS Act that passed as part of the health care reform bill?

Dr. IRVING. I am sorry to say that I do not know enough about the CLASS Act, but I will discuss the issue and our proposal in more general terms. Senator Cardin—who has just left—included in a budget process bill that he and former Chairman Nussle designed, “We believe that you should adapt a version of credit reform to insurance, to include and account for the ‘missing premium.’ ” Let me elaborate.

If the actuarial and fair premium would be $100 and we are charging $10, the budget should show $90. You are putting the government on the hook. Of course you would have to set up the kind of implementing mechanisms we have with credit reform.

Under credit reform, we have changed the way we budget for loans and loan guarantees. Before, direct loans looked like grants, and loan guarantees looked free. Now we need to be able to compare insurance programs on a more even basis so that we understand the budget implications. Some will be easy to estimate because they are similar to private insurance. Some will be harder.

But the estimates will only get better if they are going to show up in the budget, and I think that will let us do it.

We have also suggested increasing information on something I think you cannot score, but where better disclosure is warranted: fiscal exposures, the kinds of things that are implicit promises. Fannie and Freddie come to mind.

Senator THUNE. Right. Thank you. Mr. Chairman, my time has expired. Thank you.

The CHAIRMAN. Thank you, Senator.

As I understand you, Senator Gramm, you are essentially saying, do all you can and do a lot in terms of addressing the deficit before and, to some degree, independent of raising the debt ceiling.

If that is correct, my next question is, how detailed do you think it must be to be credible? Let us say we were to set some kind of a trigger in place, but with other provisions, prior to addressing the debt ceiling.

Whatever it is has to be credible, and I am asking what kinds of things you think would make it credible, as in what kind of down payment on deficit reduction, how much, and so forth.

Senator GRAMM. Well, Mr. Chairman, let me say I think program changes are always credible. I am sure a lot of Americans pooh-poohed the little reduction in the CR, but to actually reduce spending in a fiscal year was a pretty dramatic change in public policy.

People were critical of the fact that unobligated balances were reduced and caused spending cuts, but, look, in the environment we are in, those unobligated balances would have been spent at some point, for sure.

So I think action will be appreciated, whatever it is. I think the bigger, the more dramatic, the better. I think entitlement reform is critical, but also there has been such a growth in discretionary spending, I think that it has to be part of the equation.

If you are going to have an enforcement mechanism, it has to be real, it has to be binding. The thing about supermajority votes is they force you to make a case that a waiver ought to be made.

Under the pay-go sequester process—and I am not trying to be critical of it—it was waived every time by a majority vote in the House.

I think to have credibility, you have to have a system people can look at and say, “This thing is going to be hard to get around.” It is going to force members to get together and reach some kind of compromise.

Again, I think the market will react, the economy will react to anything that is credible.

We have the Fortune 500 companies today that are sitting on $2 trillion of cash. This recovery is lagging because investment has not taken off. I think anything that says to the private sector, "Government is functioning, hard decisions are being made," I think will get a positive response in the market.

The CHAIRMAN. Why not, given all that, a trigger that has debt, not spending? Debt as an appropriate level of GDP, because that enables people to have a little cover as to how much of that is spending and how much of that is revenue.

Senator GRAMM. That is not a big deal to me.

The CHAIRMAN. Just to get something started here.

Senator GRAMM. I think the advantage, Mr. Chairman, of the deficit rather than the debt is the public has an intuitive concept about balancing their budget. They find that appealing in government.

Success in the debt is simply stopping it from growing, and that is something to be devoutly wished and would be a great achievement, but I just doubt it would be as easily understood. But either one would work.

The CHAIRMAN. Turning to another subject, I agree that our corporate rate, statutory rate is way too high. We have to get it reduced. The question is, how do you reduce it enough, and I think—I could be wrong on this—but say, if the 35 reduced to 26, it would probably mean that all tax expenditures would have to be repealed, including deferral, including the R&D tax credit, and it is, obviously, something that does not make sense.

So we have to find some system that lowers the rate. One possible way some have thought of is tax pass-throughs, treat them as corporations after they earn a certain income, because so much business income today is through pass-throughs, in addition to corporate—in addition to C corps. And just lowering the rate only and eliminating a lot of tax expenditures is not going to provide enough revenue to get the rate down to a low enough level to make the difference that most people are looking for.

So we are going to have to maybe look at pass-throughs and say they have to be treated as corporations if they earn above a certain income. That is just one possibility. But we have to—there is so much pass-through income today, business income, we are going to have to figure out some way to address that as well, if we are going to get the corporate rate down to what you want.

Senator GRAMM. Well, I think whatever you could do on the corporate rate would be beneficial, because, again, we are so far now out of line that I know you have seen—because you look at this stuff as much as anybody—that over a 10-year period, a substantial manufacturing facility, because of the tax rate, can be $1 billion more expensive in the United States than it would be, say, in Ireland.

And it is something that—because other countries have taken action, that we are way——

The CHAIRMAN. There is no question.

Senator Hatch?

Senator HATCH. Thanks again, Mr. Chairman.

Dr. Irving, you said that the public does not hate spending programs, at least as I understand it. I basically think your implication is that those who oppose the unique mechanism of automatic tax hikes is the explanation for that.

Those of us raising concerns about throwing taxes into a sequester are not saying that spending programs are not popular. What we do not buy into is this, number one, that taxation is the ultimate legislative power. Think of *McCulloch v. Maryland,* where they basically said that the power to tax involves the power to destroy.

And as legislators and, most importantly, as representatives of the people, it seems to me we should be very reluctant to directly or indirectly yield that power. Now, I think Senator Gramm underscores the lack of accountability that comes with setting up an automatic tax increase.

Number two, tax expenditure numbers do not translate on a dollar-for-dollar basis like spending. I would direct anyone who is interested in this point to the Joint Committee on Taxation's tax expenditure pamphlet that they put out.

And, number three, it has been said that the tax expenditures distribute to high-income taxpayers. Now, for some on the other side, it is implied that they should all be eliminated.

Now, the reality is much simpler. Tax expenditures distribute to taxpayers, and that means the folks who have paid the freight for government, at least some of them do. That is the middle-income taxpayer, the upper-middle income taxpayer, and, of course, the high-income taxpayers.

Unlike spending, tax expenditures vary with the rate structure and other components of the system. So I am a little bit concerned about some of the comments that have been made here.

Dr. IRVING. Senator Hatch, thank you very much for giving me a chance to elaborate and possibly clarify.

I agree that taxation is the ultimate legislative power and you would not want to hand over that power to someone else.

Spending the public's money is also a constitutional power, and, presumably, you would design a very specific automatic enforcement such that Congress had legislated it to kick in.

I agree with you. At GAO, my colleagues in the tax area have done a great deal of work on tax expenditures, and we are very cognizant of the fact that they do not translate on a one-for-one basis. In part, it depends on which one you count first.

Indeed, I think of them not so much like discretionary appropriations, but more like entitlement programs, in that they are automatic and they do not get reviewed. Yes, they advantage the upper income, but that is a function of the progressive income tax, except in the case of tax credits.

I believe that the approach to reducing the debt-to-GDP ratio is going to involve both revenues and spending. I believe that an enforcement mechanism has to be unpleasant—which is why I am not so clear what exceptions I think should exist—and balanced. These lead me to raise some issues for your consideration.

Making the enforcement mechanism unpleasant and visible is probably why, in the past, people like Martin Feldstein 30 years ago, in the President's 1984 budget, included surtaxes. They are much more visible and therefore make it much easier to say, "If I do not act, you will get hit with a tax increase," because we have enacted a surtax contingent on a certain event. So I do not think of it as giving away the store. Across the board cuts in mandatory spending programs do not deal with the underlying structure of those programs.

Similarly, across-the-board cuts in tax expenditures do not address the underlying question of whether the way you have provided assistance through the tax code is the way you wish to provide such assistance.

At GAO we note that, among the greatest issues vis-à-vis tax expenditures are that they do not get the kind of evaluation and scrutiny given spending programs and that they are not examined along with those spending programs. So, for instance, we may provide aid to one industry through a spending program, to another industry through a credit program, and to another industry through special tax provisions. However, we do not look at those as a whole.

You, as the Finance Committee, can see the assistance run through the tax side. You do not get to compare it to the support that runs through appropriations, and, therefore, you do not get a whole picture of what is the best way—which tool do I wish to use for a given purpose.

You are right. If you want to tackle tax expenditures, I think it would be good to tackle the underlying structure of the individual ones. Which ones do you wish to convert to credit so they are the same for everyone?

Senator GRAMM. Mr. Chairman, may I just make the following comment, that the process that is being described here looking at tax credits, looking at expenditures, is what Congress is about. It is about what the legislative process is about. It is what compromise is about.

But there is a big difference between saying, with a spending sequester, if Congress fails, Congress gets to spend less and saying, if Congress fails, working people get to spend less.

Now I know, sitting here, you can clinically talk about tax expenditures, but let me tell you, Joe and Sarah Brown, who are getting the ability to deduct the mortgage interest on their home—the money they put into the plate at First Baptist Church—when you start saying, because Congress failed, we are raising your taxes, we are not spending—we are asking you to spend less even though you had no voice in this, no direct voice—I think you have jumped over a whole bunch of ditches that you are going to end up falling back into.

And as far as President Reagan's contingency tax, it was something Congress had to debate. It was something they could adopt or not adopt. He never proposed it as some kind of mechanism that would happen automatically, and I think that is the problem.

I think, again, I am being repetitive, but I will make the point one more time. There is too much in this enforcement mechanism about getting into revenues. There is too much judgment about what people think Congress ought to do rather than a mechanism that happens automatically if they fail to act.

And I do not think you can punish working people because Congress does not do its job. You have to punish Congress. And for Congress, that is their ability to spend money. That is their ability to set their priorities, and I think that is the key dividing point, and I think it is why the idea of automatic tax increases will never fly.

Senator HATCH. Well, thank you. I apologize for having had to leave the hearing for a few minutes. I had to go down to the Judiciary Committee.

But let me just ask one last question, and then we will wrap this up, and this is a question for everybody on the panel, if you care to answer.

Last November 21, Stephen Moore and Richard Vedder, they wrote an article in the *Wall Street Journal*. It updated a 20-year-old analysis of an Ohio University study of the relationship between higher taxes and future spending.

Now, Moore and Vedder concluded that for every $1 in new revenue Congress raises, it spends $1.17. I would like the panel to just provide suggestions on how any tax hikes from a budget deal do not end up in spending, if you can.

Let us start with you, Dr. Van de Water, then we will go to you, Dr. Irving, and then to Senator Gramm.

Dr. VAN DE WATER. Well, I am not familiar, Senator, with the particular study that you cite. Obviously, the issue that we are discussing this morning, though, is precisely that of how to establish budget enforcement mechanisms that might, first of all, prompt action to reduce the deficit and, second, make sure that agreements, once reached, are adhered to.

Senator HATCH. Let me just interrupt you for a second. In the late 1980s, Richard Vedder and Lowell Galloway of Ohio University, they coauthored an often-cited research paper for the Congressional Joint Economic Committee known as the "$1.58 study." I do not know whether you have heard of that or not.

Now, that study found that every new dollar of new taxes led to more than $1 of new spending by Congress, and subsequent revisions of the study over the next decade found similar results. Finally, this study came down to $1.17 with updated research, using standard statistical analysis that introduced variables to control for business cycle fluctuations, wars, and inflation.

They found that over the entire post-World War II era through 2009, each dollar of new tax revenue was associated with $1.17 of new spending.

In other words, the message here is politicians spend the money as fast as it comes in—and a little bit more.

Dr. VAN DE WATER. But what I was going to suggest, Senator, is I think that actually contrary, in some respects, to what Senator Gramm says, the enforcement mechanisms of the 1990 Budget Enforcement Act really did work.

I would point people to a very useful review of that experience which the Congressional Budget Office did in early 2003 after the BEA provisions expired. There has been considerable discussion this morning about emergency designations, eliminating balances from pay-go.

But what the CBO analysis—and I just refreshed my memory with it this morning—clearly shows is that those developments, the extensive use of emergencies and so forth, did not start to come into play in any significant way until the Federal budget was actually balanced at the end of the 1990s.

So I read that experience as being a quite positive one, suggesting that the budget enforcement provisions actually did work for as long as they were needed to achieve their goals.

Senator HATCH. Dr. Irving?

Dr. IRVING. Like Paul, I am not familiar with that study, and I would want to look at it, including, of course, how much of the spending growth was for things like Social Security benefits that are not connected to decisions at the time.

But I am familiar with something that predated Paul's time at the Center which actually came to the opposite conclusion on some of the deficit reduction agreements. The Center for Budget and Policy Priorities had an analysis looking at what happened when there were agreements in which there were both spending cuts and revenue increases. They found when there were revenue cuts, then the spending folks said, "Oh well, then I can spend, too." In general, tax cuts and spending increases went together, or tax increases and spending cuts.

But as I said, it is a recollection from the past. I have also seen the same study by CBO that Paul just referred to. If you are looking at a debt-to-GDP target over time and a path down on savings targets in terms of how you reduce and there is a commitment and an enforcement procedure, which is what you are looking at it, I do not think that result is inevitable.

Senator HATCH. Senator Gramm?

Senator GRAMM. Well, Mr. Chairman, I remember the 1990 budget agreement. I sat through all those long sessions out at Andrews Air Force Base. And I also remember that we missed the discretionary target by $100 billion. At least my trusty aide tells me that he may have made that figure up, but in any case, you do not miss discretionary targets by accident.

The only way you can miss a discretionary target is if you spend the money and you appropriate the money. It is not like entitlements.

So I do not remember them being that good, but, look, any enforcement is better than none. The advantage of the 1990 agreement was, at least you had an agreement to try to enforce. Whether it was good or bad, everybody had their own opinion.

I would just make two other points. One, when you raise people's taxes, you affect their behavior as producers; and, two, I do not think, as we are throwing this term "tax expenditure" around, that we have a good definition.

If you give somebody an Earned Income Tax Credit that they do not earn, so that you are paying right out of the Treasury, maybe that is a tax expenditure. If you give somebody a payment for producing something and it comes right out of the Treasury as a check, maybe that is an expenditure.

But letting people deduct their contribution to the church or their mortgage interest, maybe you should or should not do those things, but it is hard to call that a tax expenditure.

Senator HATCH. That is a policy.

Senator GRAMM. So it is true now that the largest welfare agency in the Federal Government is the IRS. The IRS is sending more checks to more people in larger amounts than any other agency, other than Social Security, Medicare, and Medicaid.

So maybe if somebody wants to deal with this, they ought to get a better definition of what is a tax expenditure. But you are never going to convince working people that their ability to deduct child care is a tax expenditure.

I think that is a distinction that gets lost in this kind of clinical term. You are raising people's taxes if Congress fails, and I just do not think they will stand for it, and should not.

Senator HATCH. Well, thank you. And another premise to the debate on our Federal situation that needs to be made, it seems to me—needs to be made clear—those on the other side make the assumption that our revenue base has been gutted and it is a main or primary cause of the deficit.

Now, with taxation and current policy, revenues tend, over the long-term, to be around 18 percent, where spending tends to be around 20—a little bit more than 20 percent, about the average of the GDP.

Now, spending and taxes are not equal players in the source of the problem, it seems to me. But let me just say this. I want to thank all three of you for being here. This has been an important hearing, as far as I am concerned, and I think everybody feels exactly the same way.

And I know it takes time out of your busy schedules to be here, but we are grateful to you and grateful for the testimony that you have all given.

With that, we will recess the committee. Thanks so much.

[Whereupon, at 12:01 p.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

Hearing Statement of Senator Max Baucus (D-Mont.)
Regarding "Trigger" Budget Enforcement Mechanisms

Confucius said:

"He who does not economize will have to agonize."

Over the last decade this country has failed to live within our budget. The debt held by the public as a percent of our total economy is now quite high – about 69 percent of the Gross Domestic Product, or GDP.

Now is the time for us to remember the warning Confucius gave. It is time to craft deficit reduction legislation that will stabilize debt held by the public by 2014 or 2015, and it should continue to reduce the deficit in the following years as well.

At the same time, the debt ceiling needs to be raised to accommodate dollars we've already spent.

As we consider a framework for major deficit reduction over time, one policy we may want to consider is a budget enforcement mechanism. How would we create a budget enforcement mechanism?

First, we would set a limit tied to a specific measure of our economy. This limit could be the level of debt held by the public or the level of federal spending as a percent of our economy.

Then, if our economy reaches that limit, it would trigger an automatic response. It could trigger an across-the-board reduction in spending, an increase in revenue or a reduction in tax expenditures, or some combination.

The trigger would encourage efforts to pass a deficit reduction package progress and conclude in a timely manner. If necessary, it would make sure the deficit reduction this economy needs is accomplished.

The President has proposed a mechanism called the Debt Failsafe Trigger. Others have put forward their own proposals as well.

One proposal, put forward by Senators Corker and McCaskill, would cap spending at 20.6 percent of GDP within ten years. If the cap was breached, an automatic, across-the-board spending cut would take effect.

This type of proposal presents some significant challenges.

First, it would encourage domestic spending programs to be administered through the tax code, and our tax system would become even more complex.

This proposal would also cut Social Security, Medicare, and Medicaid significantly. These cuts would have a huge, negative impact on the most vulnerable Americans who count on these programs to make ends meet.

But, there's a catch. If Medicare, Medicaid and Social Security were exempted from an across-the-board-cut, the cuts to other programs would be far too large to bear. That is a significant downside to this type of trigger.

We must also consider the President's trigger proposal. This plan would place a cap on debt as a percent of GDP, instead of spending as a percent of GDP. The target would be set to stabilize debt as a percent of our economy by the middle of the next decade and continue reducing the debt in the years that follow.

This approach provides more tools to meet our significant fiscal challenges. It would allow us to use both revenues and spending to decrease the deficit and debt.

There is certainly a precedent for this type of trigger. President Reagan's 1984 budget included a "contingency tax" that would have only been triggered on if economic conditions reached certain levels. The proposal would have triggered a one percent tax surcharge on individuals and corporations as well as an excise tax of $5 per barrel of oil.

Today we will ask how a trigger mechanism would work.

In what year should the trigger be set? Should the trigger take place in just one year, or are there advantages to phasing in or extending a trigger over a series of years? And, how would a trigger affect our economy in an economic downturn?

In a sluggish economy, revenue slows and spending on unemployment benefits and Medicaid increases, which adds to the deficit.

As a result, a trigger would slow spending to compensate. But the worst time to be cutting spending is in an economy battling to recover, because cutting spending would deepen the economic decline.

We must ensure that any trigger we consider would not worsen our economy and leave people out in the cold when they need help the most. I look forward to taking a close look at these trigger proposals today.

It is my hope that this type of proposal can help us get our deficits and debt under control, so our economy can grow and create the jobs Americans deserve.

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Gramm-Rudman as a Deficit Control Device
Testimony before the Senate Finance Committee
May 4, 2011
By Phil Gramm*

*Vice Chairman of UBS Investment Bank. The opinions expressed in this testimony are solely my own.

The deficit debate of today is eerily similar to the debate that occurred in 1985, when Gramm-Rudman became law. Yet the conditions demanding action today are far more compelling and far more dangerous. The deficit today would have been unimaginable in 1985. The economy in 1985 was booming, Social Security had been reformed, the Cold War was being won and a massive peace dividend was on the horizon. The retirement of Baby Boomers was a distant concern. Today we are experiencing the weakest recovery of the post-war period. Baby Boomers are retiring in great numbers, plunging first Medicare and then Social Security deep into the red. And as we fight three simultaneous conflicts, the American defense budget is stretched thin. If now is not the time for dramatic action – for entitlement reform, for binding restraints on spending – will that time ever come?

Gramm-Rudman was introduced in September of 1985 as an amendment to legislation increasing the debt limit from $1.8 trillion to $2 trillion. The debt limit today is an astonishing $14 trillion. Gramm-Rudman had 43 bi-partisan co-sponsors and received 75 votes in the Senate.

As it is today, in 1985 it was easy for policymakers to oppose the deficit solutions presented by those with the foresight and courage to offer specific plans. But nobody was willing to argue against the need to address the deficit. Then, as now, you could be against someone else's plan, but you couldn't be against every plan. Doing nothing was not a tenable political option.

Gramm-Rudman set a declining series of maximum deficit targets for each of the years 1986 through 1991. The targets were enforced by automatic spending cuts, called sequesters, that cut both defense and non-defense expenditures by equal amounts. The cuts were across programs, projects, and activities so as to preserve Congress' relative priorities; but there was some flexibility and there were some constraints. The law allowed Congress to meet the deficit targets with priorities of its choosing, but if the deficit targets for each year were not met, then the sequester would kick in and make up the difference with across the board spending cuts. Gramm-Rudman's greatest strength was that by threatening across the board cuts, it gave Congressmen and Senators an incentive to make hard choices and provided a shield against those who criticized their choices. You didn't necessarily have to agree with specific policies being implemented, but they were generally better than across the board cuts.

Our experience with Gramm-Rudman showed clearly that if you hoped to deal with the deficit by building a four-sided fort, pulling up the drawbridge and going back to sleep, you were going to be disappointed. Probably the best that any mechanism can provide is to help force action and tilt the process to encourage hard choices and compromise. At its best it can become a good stone wall to your back in a gunfight.

Did Gramm-Rudman work? I would say the answer is yes – but a qualified yes. Under Gramm-Rudman, spending growth plummeted to 4.7% in 1986 and to just 1.4% in 1987 – the slowest annual growth rate in 20 years. For the entire period when Gramm-Rudman was in effect, spending grew at the lowest rate since the 1950s. The only new entitlement created during the Gramm-Rudman period was Medicare Catastrophic Coverage. It was then and still is today the only entitlement ever created in American history that was truly paid for. And since people had to pay for it, they hated it, and it was subsequently repealed. Under Gramm-Rudman, the deficit declined substantially from 5.1% of GDP to 2.8% of GDP by 1989 – the last full year before Gramm-Rudman was automatically de-triggered by the first Iraq war and the 1990 recession. Under the language of Gramm-Rudman, a war or a recession was deemed an emergency and the law was set aside.

Based on our experience with Gramm-Rudman, and with 20/20 hindsight, I believe a series of changes should be made in it or any other mechanism that is used to help address the nation's fiscal crisis. Super majority points of order should apply to both Houses of Congress, not just to the Senate. The law should include a look-back sequester which corrects for deficit overages when the actual deficit spending totals for the year are calculated. This would allow for mid-course corrections to keep the nation on a deficit reduction glide-path before the deficit targets become unachievable. If you get behind on the deficit reduction targets, your process no longer threatens the deficit. Instead, the magnitude of the deficit begins to threaten your process.

The most abused part of Gramm-Rudman was the so-called "emergency" designation. That process was also abused under subsequent budget measures. In the extreme case, funding for the Decennial Census was designated as an "emergency" despite the fact that the Constitution had required that a census be taken every decade for 200 years. I would recommend that an emergency be declared only with the approval of 60% of the members of both Houses of Congress. In reality, if you can't get that vote, you don't have a real emergency.

The only forcing mechanism that Congress has ever employed has been automatic spending cuts. They were used in Gramm-Rudman and adopted as part of the 1990 budget summit agreement, which was supported by both Speaker Foley and Majority Leader Mitchell. Most recently, they were part of the pay-as-you-go provision adopted under Speaker Pelosi and Majority Leader Reid and signed into law by President Obama as part of raising the debt ceiling on February 12, 2010. While the pay-as-you-go provision was always waived, had it not been waived, there would have been a spending sequester quite similar to the sequester employed under Gramm-Rudman.

The logic of this enforcement mechanism is straightforward. Spending programs are a creation of Congress and represent the priorities of its members. Anything that threatens those priorities is a forcing mechanism for action. It was never the objective of Gramm-Rudman to trigger the sequester; the objective of Gramm-Rudman was to have the threat of the sequester force compromise and action. Recent proposals that would trigger automatic tax increases if Congress and the President fail to meet spending or deficit targets would, in my opinion, have a pernicious effect on the whole process. The idea that if elected officials fail, then taxpayers pay the price is a "heads, I win, tails, you lose" process that will virtually guarantee that targets are not met. Under Democrat and Republican Presidents and Democrat and Republican Congresses, spending triggers have been chosen because they make sense. Automatic tax increases have never been employed because they don't make sense.

America has no special dispensation that guarantees we will always be the greatest, richest, and freest people in the world. America can be as strong as we make it or as weak as we allow it to become. We must face up to our national debt crisis or be overcome by it. And we must do it now. To raise the debt ceiling again without requiring action now to deal with the problem is irresponsible and dangerous to the future of America.

Questions for Phil Gramm
Finance Committee Hearing on Budget Enforcement Mechanisms
May 4, 2011

Question from Senator Baucus

1. In all of it's incarnations I have never seen spending controls circumvented with tax expenditures. It maybe a theoretical problem but I don't see any evidence that it has happened or is likely to happen.

All of the automatic enforcement mechanisms that have been adopted: Gramm-Rudman, the 1990 Budget Summit Agreement and the Pelosi-Reid-Obama Pay-As-You-Go sequester all have given some special treatment to health programs. As I recall the old Gramm-Rudman law limited cuts to Medicare to 2% annually. It is my understanding that the pay-as-you-go sequester would have allowed deeper reductions in Medicare with a 4% per-annum reduction. I have not seen the President's proposed sequester process. My recommendation is to make the automatic cuts as broad based as possible, since the objective is to induce Congress to find them unacceptable and to do what they have to do to prevent the cuts from going into effect.

Question from Senator Kyl

1. No one ever seriously considered automatic tax increases in any of the previous automatic enforcement mechanisms. The idea that tax payers would be punished if Congress and the President failed to do their job never was deemed to be reasonable. My concern is that the inclusion of an automatic tax increase could be a pernicious provision that would put the taxpayer in a heads, I win, tails, you lose situation and actually encourage an action.

I think the world capital market would view either a technical default, by not passing a debt ceiling, or passing a debt ceiling without taking action to deal with the underlying deficit and debt problem as a negative. I think every effort should be made to pass a debt ceiling extension and significant reductions in deficit spending simultaneously. As I said during the hearing however, I would rather try to explain to my grandchildren why I didn't raise the debt limit instead of explaining to them why I let the greatest country in the history of the world go broke.

STATEMENT OF HON. ORRIN G. HATCH, RANKING MEMBER U.S. SENATE COMMITTEE ON FINANCE HEARING OF MAY 4, 2011 BUDGET ENFORCEMENT MECHANISMS

WASHINGTON – U.S. Senator Orrin Hatch (R-Utah), Ranking Member of the Senate Finance Committee, today delivered the following opening statement at a committee hearing examining fiscal discipline mechanisms under federal budget law:

I appreciate your calling these hearings, so that we can examine in detail the sources of our nation's debt, the drivers of our annual deficits, and the fiscal challenges posed by both.

As we all know, Congress is facing a big challenge with the upcoming debate over hiking the debt ceiling. This is the third time Congress has been asked to raise the debt limit under this Administration — once as part of the stimulus bill, twice in December of 2009 and then again in February of last year.

Three requests to raise the debt limit from this Administration in three years. Obviously the government's spending is out of control. The citizens of Utah could not be any more clear about what they want us to do. They want us to stop the spending. And I suspect that members of this Committee and of the entire Senate are hearing the same from citizens and taxpayers who are tired of spending as usual.

National polling data is consistent with what I hear from Utah taxpayers. A new USA TODAY/Gallup Poll shows that Americans are pessimistic about the economy and the sustainability of our nation's fiscal trajectory.

According to this poll, Americans *"[o]verwhelmingly blame too much spending for soaring federal deficits and want to rely more on spending cuts than tax hikes to get it under control."*

Well, I can heartily agree with that.

Another poll from Resurgent Republic indicated that almost half — 47 percent of respondents — want substantial spending cuts attached to legislation that would increase the debt ceiling.

That might give a glimmer of hope to those who wish to continue our current spending spree.

But they should not get too excited. The same poll showed that 35 percent oppose raising the debt ceiling altogether. Only 11 percent of voters support a clean debt ceiling hike.

Why are the people of this country demanding spending restraint?

As a nation, we are on the verge of a real fiscal crisis. The government continues to borrow money to fuel its spending habits. Spending is now trending at historic highs, 25.3 percent of GDP in the latest fiscal year.

Meanwhile, our debt is at an all-time high, and assuming the continuation of current policies supported by both Republicans and Democrats, it is trending toward 100 percent of GDP.

And the American people get it. They understand what is causing all of this debt.

The same poll from USA Today found that by a margin of over 3 to 1, Americans say the deficits result from too much spending rather than too little revenue.

There is no pulling the wool over the eyes of the people on this issue. There is no spinning the people into thinking that our problem is a lack of revenue. And there is no convincing taxpayers that the solution to out-of-control government spending is giving the government more money to spend.

Mr. Chairman, I ask unanimous consent that a copy of both of these articles be inserted into the record.

Congress will be following the will of the people if it attaches spending restraint -- based fiscal reforms to the debt ceiling increase.

But what will happen if, once enacted, those fiscal reforms fall prey to gimmicks, are waived, or otherwise undermined? My sense is that the people will come to this Capitol with pitchforks and torches they will be so upset. And they'd be right to do so.

Yet, if history is any guide, these reforms may ultimately leave the people betrayed and disappointed.

Congress has attempted to pass meaningful legislation to control Washington spending before. First in 1974, Congress passed the Congressional Budget and Impoundment Act, which created the House and Senate Budget committees, in addition to the Congressional Budget Office. Eleven years later in 1985, Congress passed the Balanced Budget and Emergency Deficit Control Act, otherwise known as Gramm-Rudman Hollings. I very much appreciate Senator Gramm's willingness to come back and testify regarding this legislation today.

We need to make sure that this time is different.

Every so often, the American people make it absolutely clear to Congress that Washington needs to get spending under control. And Congress has responded.

But after a few years, when the people go back to their businesses and families, Washington returns to its big-spending ways. Slowly but surely Congress end-runs the spending restraints the people had previously insisted upon.

Just as an example, the vaunted statutory pay-go rule was supposed to rein in deficit spending. Yet since the enactment of statutory pay-go, the cost of end-running this rule resulted in $280 billion in additional deficit spending.

This time must be different.This time we must make meaningful and lasting reforms. We must make the fundamental changes to our spending programs that might be tough today, but that will make maintenance of budget discipline easier in the future.

The fact is, we can't be having this debate again in another 5 years.

We are already nearing a point where it is too late to enact the changes that the markets demand. And failure to act now will have a lasting detrimental impact on families, businesses, and the economy.

The markets have taken notice of Washington's profligate ways and they are responding as you would expect. When Standard & Poor placed the United States' AAA bond rating on a negative outlook, citing a greater than 1 in 3 chance of a downgrade within the next two years, that should have served as a shot across the bow of this committee and the entire Congress.

So today's hearing is both crucial and timely.

No matter what happens with the debt ceiling, we need to make sure that Congress and the President stick to the fiscal reforms attached to the legislation. Both parties must accept responsibility, buckle down, and make the tough decisions, even when it hurts.

We may agree to disagree, as the President has often said, but we cannot agree to pass this debt and on to our children. Doing so is irresponsible, immoral and unacceptable.

I look forward to hearing from our witnesses, and hope that some of their recommendations can guide Congress as it moves forward in the coming weeks and months.

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SUBMITTED BY SENATOR HATCH

From *U.S. News and World Report*

Poll Shows Obama Is Losing the Debt Ceiling Debate

By Peter Roff

April 27, 2011

The latest national survey from Resurgent Republic shows that President Barack Obama is losing the argument over how best to handle the vote on raising the debt ceiling.

"President Obama's request that Congress pass another increase in the federal debt limit and his argument that it should be a 'clean' debt ceiling increase without preconditions limiting spending," the groups reports, "meets with overwhelming opposition from voters clearly frustrated by mounting federal debt."

Obama's position is supported by only 1 out of every 10 voters, the least popular of three options presented in the survey.

This survey of 1,000 registered voters was conducted April 17–20, with respondents selected randomly from a random-digit-dialing sample including both cell phone and landline telephone numbers. All respondents confirmed they were registered to vote in the county in which they live. The sample was minimally weighted to reflect the current Pollster.com Democratic advantage of four points over Republicans—34 percent Democrat, 32 percent independent, and 30 percent Republican.

The second-ranking option overall—not raising the debt limit under any circumstances—places second among independents and Democrats while being the top preference for Republicans surveyed.

The most popular option, "drawing support from a plurality of voters overall" is to raise the debt limit but only with accompanying spending cuts and a commitment to reduce the deficit.

"The days of 'routine' debt limit increase votes may be history, with voters holding firm views about the debt ceiling vote in a time of concern over the economy and a pervasive view that 'we have got to stop spending money we don't have,' " a sentiment that confirms the trends found in the group's recent polling.

From *USA Today*

GOP's Gamble on the Budget Pays Off, So Far

By Susan Page

April 26, 2011

WASHINGTON—A new *USA Today*/Gallup Poll finds that House Republicans, who took a political risk in passing a controversial budget blueprint last week, have survived so far with some key advantages intact as Congress moves toward the debate on raising the debt ceiling, passing the 2012 budget and enacting a long-term deficit plan.

Americans are evenly divided between the deficit plan proposed by President Obama and the one drafted by House Budget Chairman Paul Ryan, and those surveyed put more trust in Republicans than Democrats to handle the federal budget and the economy.

Pessimistic about the economy and the nation's course, they overwhelmingly blame too much spending for soaring federal deficits and want to rely more on spending cuts than tax hikes to get it under control.

The poll also shows the perils ahead for the GOP in moving from general principles to specific actions. Two-thirds of Americans worry the Republican plan for reducing the budget deficit would cut Medicare and Social Security too much.

Ryan and other Republican House members already have faced hostile questions at town-hall-style meetings in their home districts from seniors and others about the GOP proposal to turn the nation's health care program for the elderly into what would essentially be a voucher system. The GOP budget blueprint would overhaul Medicare, turn Medicaid into block grants for the states and trim trillions of dollars in spending on discretionary programs. It would lower tax rates for top earners and corporations.

"The bad news for the Democrats is that even after the Ryan budget comes out and has been attacked for a little while, the Republicans have an advantage," says Joseph White, a political scientist at Case Western Reserve University who studies budget politics and policy.

Republicans have held their political base intact, he says, but the nation is still polarized along partisan lines, and spending cuts are easier when they're discussed in the abstract. "Everybody can find something they don't like," he says, "but that doesn't mean there's a majority to cut anything in particular."

When it comes to a plan to curb the deficit, Americans have qualms about both parties:

• Nearly three-fourths of those surveyed, 71%, worry that the Democrats' plan "won't go far enough to fix the problem"; 62% fear they might use the deficit as an excuse to raise taxes.

• Nearly two-thirds, 64%, fear the Republicans' deficit plan will take away needed protections for the poor and the disadvantaged and will "protect the rich at the expense of everyone else."

By more than 3-to-1, those surveyed say the deficit stems from too much spending, rather than too little tax revenue.

When it comes to solving the deficit problem, about half of Americans, 48%, want to do it entirely or mostly with spending cuts. Some 37% support an equal mix of spending cuts and tax increases; 11% prefer mostly tax hikes.

Republicans hold a 12-percentage-point edge over Democrats as the party better able to handle the budget, and a 5-point edge on the economy in general. On a list of six issues, Democrats hold a narrow advantage only in handling health care.

Meanwhile, the country is deeply discouraged about the future. A majority of Americans say today's youth aren't likely to have a better life than their parents, a judgment at odds with the traditional American dream—the first time since the question initially was asked nearly three decades ago that a majority has held that view.

United States Government Accountability Office

GAO

Testimony
Before the Committee on Finance,
U.S. Senate

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BUDGET PROCESS

Enforcing Fiscal Choices

Statement of Susan J. Irving
Director for Federal Budget Analysis, Strategic Issues

GAO
Accountability * Integrity * Reliability

GAO-11-626T

Chairman Baucus, Senator Hatch, and Members of the Committee,

It is a pleasure to be here today as you consider the role and design of appropriate budget enforcement mechanisms in changing the government's fiscal path. My testimony today outlines some elements that could facilitate debate and contribute to efforts to place the government on a more sustainable long-term fiscal path.

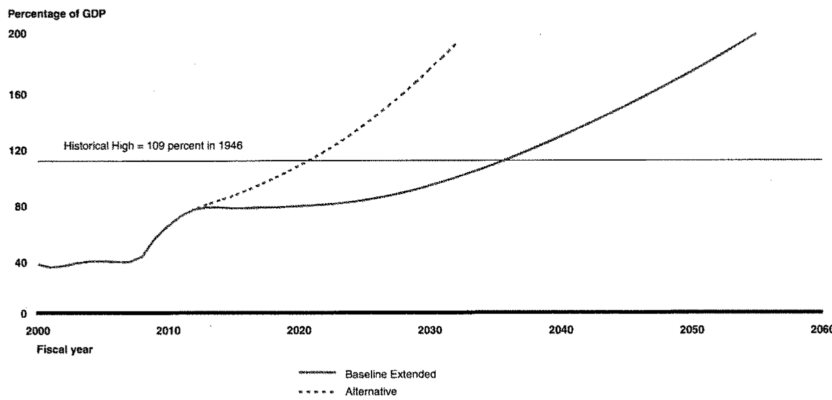
Budgeting is the process by which we as a nation resolve the large number of often conflicting objectives that citizens seek to achieve through government action. The budget determines the fiscal policy stance of the government—that is, the relationship between spending and revenues. And it is through the budget process that Congress and the President reach agreement about the areas in which the federal government will be involved and in what way.

Because these decisions are so important, we expect a great deal from our budget and budget process. We want the budget to be clear and understandable. We want the process to be simple—or at least not too complex. But at the same time we want a process that presents Congress and the American people with a framework to understand the significant choices and the information necessary to make the best-informed decisions about federal tax and spending policy. This is not easy.

We have all heard the statement "The process is not the problem; the problem is the problem," which in this case is the federal government's unsustainable fiscal path.[1] As the Committee knows, we have been raising concerns about the long-term trajectory of the budget for nearly two decades. Our first long-term simulation of the federal budget path was issued in 1992 for members of the Finance and Budget Committees. As in 1992, our latest simulations continue to show that the federal budget is structurally unbalanced and on an unsustainable path. (See fig. 1.)

[1]See GAO, *The Federal Government's Long-Term Fiscal Outlook: January 2011 Update*, GAO-11-451SP (Washington, D.C.: Mar. 18, 2011) and http://www.gao.gov/special.pubs/longterm/fed/.

Figure 1: Debt Held by the Public under Two Fiscal Policy Simulations



Source: GAO.

Note: Data are from GAO's January 2011 simulations based on the Social Security Trustees' assumptions for Social Security and the Medicare Trustees' and the Centers for Medicare & Medicaid Services Office of the Actuary's assumptions for Medicare.

Since our first simulations in 1992, we have continued to report on the nature and drivers of the long-term imbalance and on mechanisms to help address the challenge. Focusing on the long term does not mean ignoring the near term. While concerns about the strength of the economy may argue for phasing in policy changes over time, the longer action to change the government's long-term fiscal path is delayed, the greater the risk that the eventual changes will be more disruptive and more destabilizing. Starting on the path to sustainability now offers many advantages. Our increased awareness of the dangers presented by the long-term fiscal outlook leads to a focus on enforcement provisions within the budget process that can facilitate the debate and contribute to efforts to put the government on a more sustainable long-term fiscal path.

Principles for a More Transparent and Effective Budget Process

Before turning to enforcement in particular, I will discuss some broad principles of budget process since it is the framework within which enforcement mechanisms exist. No process can force choices Congress and the President are unwilling to make. Having an agreed-upon goal justifies and frames the choices that must be made. A budget process can facilitate or hamper substantive decisions, but it cannot replace them. While no process can substitute for making the difficult choices, it can help structure the debate. The budget structure can make clear information necessary for important decisions or the structure can make some information harder to find. The process can highlight trade-offs and set rules for action.

In our past work, we have identified four broad principles or criteria for a budget process that can help Congress consider the design and structure of future budget enforcement mechanisms. A process should

1. provide information about the long-term effect of decisions, both macro—linking fiscal policy to the long-term economic outlook—and micro—providing recognition of the long-term spending implications of government commitments
2. provide information and be structured to focus on important trade-offs such as the trade-off between investment and consumption spending.
3. provide information necessary to make informed trade-offs between the different policy tools of government (such as tax provisions, grants, and credit programs), and
4. be enforceable, provide for control and accountability, and be transparent, using clear, consistent definitions.

Since my comments about enforcement will be related in part to these four principles, let me touch briefly on each of them.

First, selecting the appropriate time horizon in which the budgetary impact of policy decisions should be measured is not just an abstract question for analysts. If the time horizon is too short, Congress may have insufficient information about the potential cost of a program. In addition, too short a time horizon may create incentives to artificially shift costs into the future rather than find a sustainable solution. The move from a focus on a single year to 5 and then 10-year horizons represented a major step forward. At the same time, we need to also understand the longer-term effects of policy decisions. As the first agency to do long-term simulations for the federal budget as a whole, we are well aware of the fact that the further out estimates go, the less certain are the numbers. But policymakers should be given information on the direction and order of magnitude of looming challenges. This is especially important where the short-term snapshot may be misleading. This concern has led us to propose improved recognition of the government's long-term "fiscal exposures"—which may not be explicit liabilities.[2]

Second, the structure and rules can determine the nature of the trade-offs surfaced during the budget process. Consumption may be favored over investment because the initial cost of an infrastructure project looks high in comparison to support for consumption. Distinguishing between support for current consumption and investing in economic growth in the budget would help eliminate a perceived bias against investments requiring large up-front spending. We have previously proposed establishing an investment component within the unified budget to permit a focus on federal spending on infrastructure, research and development, and human capital—spending intended to promote the nation's long-term economic growth. This proposal focuses on the allocation of spending within an agreed-upon amount. For example, we identified several options such as establishing investment targets within a framework similar to that contained in the Budget Enforcement Act of 1990. Under such an approach, and the Administration would agree on the appropriate level of investment spending within an overall target and create targets or "fire walls" to limit infringement from other activities.

The third principle focuses on the method through which the federal government provides support for any federal goal or objective. The renewed interest in overlap and duplication has highlighted the different ways in which such support is provided: direct federal provision, grants, loans or loan guarantees and tax preferences or tax incentives. These vary in design and in how effective they might be for a given mission. In addition, they vary in the timing of cash flows. The budget and budget process should provide the information necessary to permit looking across federal agencies and policy tools—which means across committee jurisdictions—to make an informed choice. Such comparisons also require that their budgetary costs be measured on a comparable basis. The Federal Credit Reform Act of 1990 addressed this issue for loans and loan guarantees; the budget now reflects the estimated size of the government's commitment, regardless of the timing of the cash flows. For federal insurance programs, however, the budget offers a misleading picture

[2]GAO, *Fiscal Exposures: Improving the Budgetary Focus on Long-Term Costs and Uncertainties*, GAO-03-213 (Washington, D.C.: Jan. 24, 2003).

about the nature and size of the government's exposure. The cash-based treatment of these programs distorts choice on several dimensions. First, at the time the insurance program is created or insurance is offered, there is no discussion of the subsidy being provided to those obtaining insurance, and second, there need not be an estimate of the likely budgetary impact over the insurance period. This means decisions about insurance programs are not made based on their likely cost to the federal government—nor is the amount of the subsidy ever recognized in the budget. Given our concerns that long-term costs of programs be understood and that programs or policies be considered on a comparable-cost basis, we recommended that the budget record the "missing premium" for insurance programs.[3]

Lastly, and perhaps of most interest given the focus of this hearing, the budget process should be enforceable, provide for control and accountability, and be transparent. These three elements are closely related and achieving one has implications for the others. Further, the way these are interpreted has implications for the design of any enforcement mechanism. By enforcement I mean not a mechanism to force a decision but rather a mechanism to enforce decisions once they are made. Accountability has at least two dimensions: accountability for the full costs of commitments that are to be made, and targeting enforcement to actions taken. It can also encompass the broader issue of taking responsibility for responding to unexpected events. For example, Congress and the President may want to consider periodically looking back and assessing the progress toward reducing the deficit. Such a process would be valuable because economic and technical factors driving direct spending program costs above anticipated levels have remained outside policymakers' control. Finally, the process should be transparent, that is, understandable to those outside the process.

I will turn now to the issue of enforcement. In considering any new enforcement mechanisms going forward, it is helpful to draw on the lessons learned from the past. Therefore, I will start with a brief history of budget enforcement mechanisms and a summary of the key lessons learned before turning to the design and implementation of budget enforcement mechanisms for today's challenges.

[3]GAO, *Budget Issues: Budgeting for Federal Insurance Programs*, GAO/T-AIMD-98-147 (Washington, D.C.: Apr. 23, 1998).

History of Budget Enforcement Mechanisms

The process created in the Congressional Budget and Impoundment Act of 1974 Act was not created to produce a specific result in terms of the deficit. Rather, it sought to assert the Congress's role in setting overall federal fiscal policy and establishing spending priorities and to impose a structure and a timetable on the budget debate. Underlying the1974 Act was the belief that Congress could become an equal player only if it—like the executive branch—could offer a single "budget statement" with an overall fiscal policy and an allocation across priorities. This was an important step.

It was not until the Balanced Budget and Emergency Deficit Control Act of 1985—commonly known as Gramm-Rudman-Hollings or GRH—that the focus of the process changed from increasing congressional control over the budget to reducing the deficit. Both the original GRH and the 1987 amendments to it sought to achieve a balanced budget by establishing annual deficit targets to be enforced by automatic across-the-board "sequesters" if legislation failed to achieve the targets. GRH sought to hold Congress responsible for the deficit regardless of what drove the deficit. If the deficit grew because of the economy or demographics—factors not directly controllable by Congress—the sequester response dictated by GRH was the same as if the deficit grew because of congressional action or inaction. If a sequester was necessary, GRH did not differentiate between those programs where Congress had made cuts and those where there had been no cuts or even some increases. Finally, the timing of the annual "snapshot" determining the deficit and the size of the sequester and the fact that progress was measured 1 year at a time created a great incentive for achieving annual targets through short-term actions such as shifting the timing of outlays.

GRH demonstrated that no process change can force agreement where one does not exist. However, the experiences gained led to the Budget Enforcement Act (BEA) of 1990.[4] This act was designed to enforce substantive agreement on the discretionary caps and pay-as-you-go (PAYGO) neutrality reached by the President and Congress. BEA sought to influence the result by limiting congressional action. Unlike GRH, BEA held Congress accountable for what it could directly control through its actions, and not for the impact of the economy or demographics, which are beyond its direct control. BEA did this by dividing spending into two parts: PAYGO and discretionary. It imposed caps on the discretionary part

[4]The major provisions of BEA expired in 2002.

that succeeded in holding down discretionary spending and through PAYGO it constrained congressional actions to create new entitlements (whether through direct spending or tax preferences) or tax cuts.

What then do I believe we have learned from GRH and BEA?

- Enforcing an agreement is more successful than forcing an agreement.
- Covering the full range of federal programs and activities—rather than exempting large portions of the budget—can strengthen the effectiveness of the controls and enforcement.
- Targeting sequestration to those areas that exceed their agreed-upon level creates better incentives than punishing all areas of the budget if only one fails to achieve its deficit reduction goal.
- Focusing on a longer time horizon can help Congress find a sustainable fiscal path rather than artificially shifting costs into the future.
- Incorporating a provision under which Congress would periodically look back at progress toward reducing the deficit can prompt action to bring the deficit path closer to the original goal.

Budget process helped once to achieve a goal that had consensus; it could work again.

Enforcement Mechanisms Moving Forward

While BEA's focus on actions offered advantages for enforcement, it did not go far enough to meet today's needs. BEA specified that Congress must appropriate only so much money each year for discretionary programs and that any legislated changes in entitlements and/or taxes during a session of Congress were to be deficit-neutral. The effect of this control on discretionary programs and on entitlements was quite different.

Spending for discretionary programs is controlled by the appropriations process. Congress provides budget authority and specifies a period of availability. Controlling legislative action is the same as controlling spending. The amount appropriated can be specified and measured against a cap.

For mandatory programs and revenues, controlling legislative actions is not the same as controlling spending or revenues. For an entitlement program, spending in any given year is the result of the interaction between the formula that governs that program and demographics or services provided. Similarly, for a tax provision, the revenue impact is not directly determined by Congress. Under BEA legislated changes in entitlements and taxes were to be deficit-neutral over multiyear periods. However, BEA did not seek to control changes in direct spending or in revenues (including tax expenditures) that resulted from other sources—whether from changes in the economy, changes in population, or changes in costs. Moving forward this is a major gap: it is the underlying structure of the budget that is driving the long-term fiscal imbalance.

BEA succeeded as far as its reach. It controlled discretionary spending and prevented legislative expansion of entitlement programs and new tax cuts unless they were offset. However, it did nothing to deal with expansions built into the design of mandatory programs and the allocation of resources within the discretionary budget. Congress enacted a return to a statutory PAYGO process in 2010.[5] As with the previous iteration, this can help prevent further deterioration of the fiscal position, but it does not deal with the existing imbalance. The problem confronting us today requires going beyond the "do no harm" or "stop digging" framework of BEA. Going forward, the budget process will need to encourage savings in all areas of the budget and contain mechanisms for automatic actions (whether spending cuts, reductions in tax expenditures, or surcharges) if agreed-upon targets are not met.

Discretionary Spending

Caps on discretionary spending—and Congress's compliance with the caps—are relatively easy to measure because discretionary spending totals flow directly from legislative actions (i.e., appropriations laws). However, there are other issues in the design of any new caps. For example, what categories should be established within or in lieu of an overall cap?[6] Categories define the range of what is permissible. By design they limit trade-offs and so constrain both Congress and the President. As I previously discussed, a category could be established for investment spending. Such a category could help Congress focus on spending that promotes economic growth within a framework that still constrains overall spending. Should these caps be ceilings, or should they—as was the case for highways and violent crime reduction—provide for "guaranteed" levels of funding?

[5] Statutory Pay-As-You-Go Act of 2010, Pub. L. No. 111-139 (Feb. 12, 2010).

[6] While the original BEA envisioned three categories (Defense, International Affairs, and Domestic), over time categories were combined and new categories were created. At one time or another caps for Nondefense, Violent Crime Reduction, Highways, Mass Transit and Conservation spending existed—many with different expiration dates.

Because caps are defined in specific dollar amounts, it is important to address the question of when and for what reasons the caps should be adjusted. Without some provision for emergencies, no cap regime can be successful. The design of any provision for emergencies can be important. How easy will it be to label something an "emergency?" If the emergency is something like a natural disaster, at what point should the related spending be incorporated into the regular budget process rather than remain an emergency exception? The regular budget and appropriations process provides for greater legislative deliberation, procedural hurdles, and funding trade-offs which may be bypassed through the use of emergency supplementals. If appropriations committee oversight and procedural controls over the enactment of supplementals—whether all spending is designated emergency or not—are less than that applied to the regular process, there may be an incentive to expand the use of supplementals. In the past we have recommended a number of steps to improve budgeting for emergencies—both in terms of how much is provided in the budget for yet unknown emergencies and in terms of procedures and mechanisms to ensure that emergency supplementals do not become the vehicle for other items.[7]

It is worth noting that discretionary spending caps leave the decision about how to comply with the caps to the committees of jurisdiction. Budget control legislation has set the level of the caps, but it has not specified how much should be spent on each department or activity under the cap.

Entitlements, Revenues, and Tax Expenditures: PAYGO Plus

Unlike discretionary spending, mandatory spending programs and tax expenditures are not amenable to simple "caps." Further, even if a cap on mandatory programs were to be designed and imposed, it would not deal with the underlying structure of these programs and hence would not address the longer-term growth trends.[8]

[7]GAO, *Supplemental Appropriations: Opportunities Exist to Increase Transparency and Provide Additional Controls*, GAO-08-314 (Washington, D.C.: Jan. 31, 2008).

[8]GAO, *Budget Policy: Issues in Capping Mandatory Spending*, AIMD-94-155 (Washington, D.C.: July 18, 1994).

An alternative that would be more consistent with the design of these programs would be to set savings targets or specify a downward trend.[9] Under the current budget process, if Congress wishes reductions in mandatory programs or increases in revenues, it may use reconciliation instructions to assign targets to the committees of jurisdiction; it does not generally direct those committees as to the specific nature of the change to meet such targets.

While changing our long-term fiscal path requires looking down the road, we should start now. If Congress were to agree on a fiscal goal and set targets along a multiyear path, then enforcement would be tied to those targets and that path. The lessons of GRH and BEA could be applied: tie enforcement to actions. A look-back provision would create a mechanism to reconcile results with intent.

The growth of some mandatory programs might be slowed by creating program-specific triggers which, when tripped, prompt a response. A trigger could result in a "hard" or automatic response, unless Congress and the President acted to override or alter it. By identifying significant increases in the spending path of a mandatory program relatively early and acting to constrain it, Congress and the President could avert larger financial challenges in the future. A similar approach might be applied to tax expenditures, which operate like mandatory programs but do not compete in the annual appropriations process.[10]

Since the growing deficit and debt is a function of the structural and growing imbalance between spending and revenues, we have said that both sides of the equation should be covered by whatever enforcement mechanism is selected. At the same time, the design of the mechanism must recognize the differences in design and hence in control of discretionary spending, mandatory spending, spending through the tax code in the form of tax expenditures, and revenues.

As a general rule, incentives or penalties—which are what enforcement mechanisms often serve as—are most successful if they are plausible and

[9]GAO, *Tax Policy: Tax Expenditures Deserve More Scrutiny*, GGD/AIMD-94-122 (Washington, D.C.: June 3, 1994).

[10]GAO, *Mandatory Spending: Using Budget Triggers to Constrain Growth*, GAO-06-276 (Washington, D.C.: Jan. 31, 2006) and *Tax Policy: Tax Expenditures Deserve More Scrutiny*, GGD/AIMD-94-122 (Washington, D.C.: June 3, 1994).

tied to a failure to act rather than imposed too broadly. As I noted, we have said that enforcement is an important part of any budget process; in designing enforcement mechanisms it is important to pay attention not only to their interaction with the design of different parts of the budget but also to any perverse incentives or unintended consequences that are likely to result.

Debt Limit

Finally, I would like to comment about one measure that does not serve as an enforcement mechanism but is often misunderstood as one: the debt limit. The debt limit does not control or limit the ability of the federal government to run deficits or incur obligations. Debt reflects previously enacted tax and spending decisions. The debt limit, therefore, is a limit on the ability to pay obligations already legally incurred. If the level of debt—or debt as a share of GDP—is to serve as a fiscal policy goal or limit, then it must constrain the decisions that lead to debt increases when those decisions are made.

Our recent work highlights some options for better linking spending and revenue decisions to the decisions about the debt limit at the time that those decisions are made.[11] For example, many have suggested that since the Congress's annual budget resolution reflects aggregate fiscal policy decisions including levels of federal debt, this would be the appropriate point in the budget process to make the necessary adjustments to the debt limit. If that were done, then Congress might also adopt a process whereby any legislation that would increase federal debt beyond that envisioned in the resolution would also contain a separate title raising the debt limit by the appropriate amount. Congress took this approach with three pieces of legislation enacted in 2008 and 2009: the Housing and Economic Recovery Act of 2008, the Emergency Economic Stabilization Act of 2008, and the American Recovery and Reinvestment Act of 2009 each included a separate provision increasing the debt limit.

Conclusion

The budget process is the source of a great deal of frustration. The public finds it hard to understand. Members of Congress complain that it is time-consuming and duplicative, requiring frequent votes on the same thing.

[11]See GAO, *Debt Limit: Delays Create Debt Management Challenges and Increase Uncertainty in the Treasury Market*, GAO-11-203 (Washington, D.C.: Feb. 22, 2011) and http://www.gao.gov/special.pubs/longterm/debt/.

And, too often, the results are not what was expected or desired. It is inevitable that, given the nature of today's budget challenge, there will be frustration. It is important, however, to try to separate frustration with process from frustration over policy. To change the fiscal path requires hard decisions about what government will and will not do and how it will be funded. A process may facilitate the debate, but it cannot make the decision. Enforcement mechanisms are not terribly successful in forcing actions when there is little agreement on those actions. Carefully designed mechanisms, however, can enforce agreements that have already been made and ensure compliance.

Chairman Baucus, Senator Hatch, Members of the Committee, this concludes my statement. I am happy to answer any questions and provide any assistance as you move forward in this important endeavor.

We conducted our work from April to May 2011 in accordance with all sections of GAO's Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis conducted, provide a reasonable basis for any findings and conclusions in this statement.

Contacts and Acknowledgments

For further information regarding this testimony, please contact Susan J. Irving, Director for Federal Budget Issues, Strategic Issues, on (202) 512-6806 or irvings@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Individuals making key contributions to this testimony include Carol Henn, James McTigue, and Thomas McCabe.

Questions for Dr. Susan Irving
Finance Committee Hearing on Budget Enforcement Mechanisms
May 4, 2011

Questions from Senator Baucus

1. **Under a spending cap, there is likely to be very little, if any, deficit reduction through revenue increases. This would generally lead to deeper and more painful spending cuts, all other things being equal. Do you agree that this is a major disadvantage of spending caps?**

In my written statement I discussed a number of elements or design criteria that I thought would be important in the design of any enforcement mechanism. GAO has said that spending caps should be part of a broader enforcement mechanism. Spending caps are most easily imposed on discretionary spending since that spending is determined by the appropriations process. Compliance with discretionary spending caps is also easy to measure: either the appropriations are under/at the level of the caps or they are not. There are, as I discussed, issues in the design of discretionary spending caps: should there be a single cap for all discretionary spending or separate caps for individual categories (Defense/ Nondefense, Security/non-security, investment/other, etc)? and how should the enforcement mechanism be designed?

Spending caps for mandatory/direct spending programs are not easy to apply. Where the spending is the result of the interplay between eligibility criteria and a benefit formula and both are set in statute, caps present real challenges. (See *Budget Policy: Issues in Capping Mandatory Spending*, GAO/AIMD-94-155, July 18 1994) and *Mandatory Spending: Using Budget Triggers to Constrain Growth,* GAO-06-276, January 31, 2006)

In a report in 2006 we pointed out that:

> Mandatory caps fail to address underlying eligibility and benefits formulas—which drive spending. In addition, if caps were imposed in the context of a control requiring across-the-board spending cuts, they would present agencies with difficulties in successfully reducing their program spending to stay within limits, and perhaps lead to a cycle of continual sequestrations. This difficulty is because in such a regime, any shortfalls in savings or growth in spending that occurred despite agency efforts would be added to the amount of cuts required in the next year. Moreover, the mandatory programs that would be most affected by a cap—because of their high and/or volatile growth rates—are also the programs for which a cap would be hardest to implement. (*Mandatory Spending: Using Budget Triggers to Constrain Growth,* GAO-06-276, January 31, 2006)

In previous years reconciliation instructions have served in place of caps for mandatory programs; this permits the committees of jurisdiction to make changes that the committees feel are the most appropriate way to reduce spending for a given program.

Nor would spending caps capture programs that are created as part of the tax code—either refundable tax expenditures (which are shown as outlays) or nonrefundable tax expenditures. In fact, a significant problem with using only spending caps for deficit reduction is that it would create an incentive to increase the range of programs established and financed through the tax code. As we have pointed out, these tax expenditures receive less scrutiny than other spending programs. (See *Tax Policy: Tax Expenditures Deserve More Scrutiny* (June 3, 1994, GAO/GGD/AIMD-94-122) and, more recently, *Government Performance and Accountability: Tax Expenditures Represent a Substantial Federal Commitment and Need to Be Reexamined* (Sept. 23, 2005, GAO-05-690).

GAO has said that everything must be "on the table" in discussions of how to change the long-term fiscal trajectory. We have suggested that enforcement mechanisms would include spending caps and a PAYGO-like provision that went beyond the "don't make anything worse" ban on new mandatory spending programs or tax cuts that was included in BEA. The BEA's PAYGO succeeded as far as its reach, but its reach was not enough for the challenge we face today. Because of their design tax expenditures are not easily subject to across-the-board cuts; imposing across-the-board reductions in the value of tax expenditures introduces more complexity than do caps on discretionary spending.

We noted in our 2006 report on Budget Triggers (GAO 06-276) that some of the experts we interviewed "pointed out that triggers need not only apply to spending; the revenue side of the budget should also be addressed. One noted, for example, that an increase in taxes to cover spending growth would increase visibility to the public and thus permit the American people to be more aware of how much they are paying for services. Applying triggers to tax cuts was an issue considered in 2001 when the budget was in surplus and tax cuts were proposed. For example, Federal Reserve Chairman Greenspan at that time expressed his preference for a trigger that would make tax cuts contingent on the realized net debt level."

2. **Gramm Rudman Hollings and pay-go have safety valves that can turn off the across-the-board cuts in spending and tax expenditures if there is an economic downturn. The President's proposal has a safety valve too. Do you believe that this is a good idea?**

Any deficit/debt reduction plan and any enforcement mechanism must take into account the automatic stabilizers in our budget that—even absent additional legislative action—cause the deficit (and the Debt:GDP ratio) to increase. As I noted in my statement, it was not until the Balanced Budget and Emergency Deficit Control Act of 1985—commonly known as Gramm-Rudman-Hollings or GRH—that the focus of the process changed from increasing congressional control over the budget to reducing the deficit. Both the original GRH and the 1987 amendments to it sought to achieve a balanced budget by establishing annual deficit targets to be enforced by automatic across-the-board "sequesters" if legislation failed to achieve the targets. GRH sought to hold Congress responsible for the deficit regardless of what drove the deficit. If the deficit grew because of the economy or demographics—factors not directly controllable by Congress—the sequester response dictated by GRH was the same as if the deficit grew because of congressional action or inaction. If a sequester was necessary, GRH did not differentiate between those programs where Congress had made cuts and those where there had been no cuts or even some increases.

3. **The President proposes a debt failsafe trigger that would require across-the-board cuts in spending programs and tax expenditures in FY 2014, if the debt/GDP exceeded a specified target in FY 2014. In other words, the proposal is to be operative in only one year. However, in principle, couldn't the same proposal be activated in more than one year, for example in each of five consecutive years?**

Annual Debt/GDP targets present some difficulties—especially in an economic downturn—since they are pro-cyclical. In a downturn, GDP falls and the deficit and debt grow even absent any legislative action. The need to change the current long-term fiscal path is complicated by the apparent weakness of the economic recovery. Given these issues, a number of individuals and groups have suggested combining a Debt/GDP target for a future year with actions that grow in size over time. For example, some have proposed a combination of a Debt/GDP target some years out with a "dollar savings goals" path that would achieve the target Debt/GDP ratio at the specified time (unless there was an economic slowdown) as a way of balancing the economic importance of Debt/GDP with the ability to monitor legislative actions and enforce the agreement. In my testimony I suggested that a "lookback" procedure would assist in monitoring progress when something other than legislative action affected the actual savings path. To illustrate how this might work, suppose Congress and the President were to agree on legislation that, at the time of enactment, is estimated to achieve both annual savings goals and a target Debt/GDP ratio in an agreed-upon year. An economic slow-down or other technical changes, however, could affect the actual path. A lookback procedure would alert Congress and the President if economic or technical changes were slowing achievement of the target; it would also prompt consideration of what additional legislative action should be taken and how it should be phased in.

4. **Health Programs Exempt From Trigger**

- **Can you describe what federal health care programs were exempt from previous sequestration proposals?**
- **How is that different from what the President has proposed?**

Under previous and current sequestration laws, low-income mandatory programs such as Medicaid and the Children's Health Insurance Program are exempt. While Medicare is not exempt, there is a cap on the spending reduction that can be applied to Medicare.
(See section 255 of the Balanced Budget and Emergency Deficit Control Act of 1985, Pub. L. No. 99-177, as amended by section 13001(c) of the Budget Enforcement Act of 1990, Pub. L. No. 101-508, and section 11 of the Statutory Pay-As-You-Go Act of 2010, Pub. L. No. 111-139)

I have not seen any legislative language for the President's proposal. The fact sheet states "Consistent with prior fiscal enforcement mechanisms put in place by Presidents Reagan, George H.W. Bush and Clinton, the trigger should not apply to Social Security, low-income programs, or benefits for Medicare enrollees."

- **What factors should Congress examine as we decide whether to exempt certain health care programs?**

- **What recommendations do you have for programs, particularly those for vulnerable Americans that should be exempt?**

Some of the issues in the design of any enforcement mechanism are analytical but even these require judgment about which criteria are most important and how to measure things like ease of implementation, effectiveness, transparency, etc. At the hearing, I suggested reasons why enforcement should hit both the tax and the spending parts of the budget. In addition, as I noted above, any enforcement provision/penalty should be unpleasant enough that all involved prefer that deliberate legislative decisions be made (rather than permit the enforcement/penalty to kick in) but not so draconian that the penalty is unrealistic. Any penalty that is too draconian to implement is not an effective deterrent.

Similarly, if all programs one would not wish to see "cut" are exempt, then triggering the enforcement mechanism/penalty may not be sufficiently distasteful to create support for what will be difficult choices/decisions but if there are no exemptions or limitations on where or to what extent the penalty is imposed, then it may be too draconian to be imposed—and/or it may do more damage to vulnerable populations than is acceptable to policymakers and the public. As a result, this aspect of the design requires a balancing and judgment appropriately made by elected officials.

In 2006 we also noted that for mandatory spending programs and for tax expenditures, there are challenges in the design of triggers:

> Any discussion to create triggered responses and their design must recognize that unlike controls on discretionary spending, there is some tension between the idea of triggers and the nature of entitlement and other mandatory spending programs. These programs—as with tax provisions such as tax expenditures—were designed to provide benefits based on eligibility formulas or actions as opposed to an annual decision regarding spending. This tension makes it more challenging to constrain costs and to design both triggers and triggered responses. At the same time, with only about one-third of the budget under the control of the annual appropriations process, considering ways to increase transparency, oversight, and control of mandatory programs must be part of addressing the nation's long-term fiscal challenges. Ignoring significant growth in mandatory accounts is inconsistent with evaluation of programs and their costs. (GAO-06-276)

Senator Rockefeller Statement for Record
Finance Committee Hearing on Budget Enforcement Mechanisms
May 4, 2011

Mr. Chairman, I remain deeply concerned about the direction of our discussions about reducing the deficit. In recent weeks, there appears to be growing enthusiasm for destructive proposals that would blindly make cuts to critical programs, including Social Security, Medicare, and Medicaid, if arbitrary targets are not met. The supporters of these proposals may mean well, but the damage they would do to the poor, the elderly, the sick and children could be catastrophic.

I believe strongly that we should take action to reduce our national debt, but I do not believe we can or should allow our nation's economy and financial stability, in the form of a vote on the debt ceiling, to be held hostage to demands for legislation that would mandate indiscriminate cuts to programs that Americans depend on.

These kinds of proposals might sound appealing in the abstract. But they have very real negative consequences for the American people. For example, one proposal to limit federal spending to 20.6 percent of GDP could not be achieved without literally trillions of dollars in cuts to Medicare, Medicaid, and Social Security.

Here is how it works: right now, the federal government matches every dollar that states or counties spend. If we block grant Medicaid, states and local governments only get a set amount of money – even if there is a tornado, or another Hurricane Katrina, or an unexpected crisis. Even the regular aging of the population is not factored in – which means more cuts and less ability to take care of their residents.

The only way to meet the arbitrary caps and avoid these drastic cuts would be to slash all other spending to unimaginable levels, or to pass radical changes to critical programs, like giving seniors a voucher to buy insurance instead of covering them under Medicare, and turning our backs on the most vulnerable Americans by converting Medicaid into a block grant.

Proposals like these are irresponsible. We cannot fall victim to the temptation to set arbitrary caps for deficit reduction, without being honest about the fact that the result will be the dismantling of programs like Medicare and Medicaid. There are no easy solutions here. We need to make the tough decisions that will bring our budget into balance.

What is even more galling about these proposals is that most leave revenues off the table entirely. They are totally unwilling to acknowledge that tax cuts for the wealthy and corporate tax loopholes are responsible for trillions of dollars of our current debt. These "tax expenditures" cost more annually than domestic discretionary spending. We cannot be serious about reducing annual deficits without putting revenue on the table.

There should be no question that we all must pay our fair share of taxes. Unfortunately, while working class Americans have kept up their end of this bargain, many multi-national businesses have not, reporting billions of dollars in profits in one accounting ledger, while reporting no taxable income in another. That has to change. Our tax code has grown fat with loopholes and giveaways that add to the debt while benefitting a few well-heeled individuals or companies.

It is time to clean up the tax code and put everyone back on level footing. This means taking a hard look at billions of dollars in giveaways to oil and gas companies, tax subsidies for purchasing million-dollar homes, and the exemption of millions of dollars of unearned income through the excessively generous Estate Tax provision passed last year.

I firmly believe that we should not require hard-working Americans to face devastating cuts to programs they rely on just at the very moment we are using their tax dollars to dole out giveaways to corporations and tax breaks for the wealthy few. In all of our discussions about how to reduce the deficit, revenue absolutely must be on the table in order to reach a result that is fundamentally fair.

I will continue to oppose efforts to weaken Medicare, Medicaid, or Social Security which would leave thousands of West Virginians and millions of Americans out in the cold. Block grants and arbitrary spending triggers simply shift the costs of health care and retirement onto low-income families, seniors, and people with disabilities. It is both unethical and ineffective to try to balance the budget on the backs of our most vulnerable citizens. We should fix our budget problems with smart, targeted spending cuts, including closing corporate loopholes, ending tax breaks for millionaires, and cutting waste at government agencies. Our system is upside-down when some Members of Congress propose cuts to hard working Americans and enable our wealthiest citizens and large oil companies to pay minimal taxes. I will fight against proposals that try to slash needed safety nets for millions of Americans.

May 4, 2011

TESTIMONY OF PAUL N. VAN DE WATER
Senior Fellow, Center on Budget and Policy Priorities

Before the
Committee on Finance
United States Senate

Budget Enforcement Mechanisms

Mr. Chairman, Senator Hatch, and members of the committee, I appreciate the invitation to appear before you today.

The federal budget is on an unsustainable path. If we continue current policies — including a further extension of the 2001 and 2003 tax cuts and AMT relief — deficits will remain high throughout the decade, and the debt will rise to about 95 percent of gross domestic product (GDP) by 2021.

Raising taxes or cutting spending is difficult work that necessitates setting priorities and making substantive policy choices. Legislators understandably find it hard to agree on which revenues, if any, should be raised and which spending should be cut. At times like this, when progress seems glacial, policymakers seek new budget processes that might promote good fiscal behavior in the future.

Previous attempts to compel policymakers to make substantive budget choices by threatening painful automatic cuts have not achieved major deficit reduction, however, and enacting fixed deficit, debt, or spending targets may prove similarly ineffective now. The Balanced Budget Act of 1985 (known as Gramm-Rudman-Hollings) set annual deficit targets, with the aim of achieving a balanced budget, and imposed automatic spending cuts (termed "sequestration") if the targets were expected to be missed. Congress repealed Gramm-Rudman in 1990 because it failed. When big automatic cuts loomed, the Reagan and Bush Administrations used rosy budget estimates to make the shortfall "disappear" on paper or to reduce the size of the required cuts. Then the Administration and Congress either used budgetary gimmicks — such as asset sales, timing shifts in program spending, and moving entities "off budget" — to address much of the remaining shortfall, or they raised the deficit target.

The Budget Enforcement Act (BEA) of 1990 replaced the fixed deficit targets of Gramm-Rudman with a process designed to enforce compliance with the deficit-reduction measures agreed to at the 1990 budget summit. The BEA established caps on discretionary spending and a pay-as-you-go requirement that legislation affecting mandatory spending or revenues not add to the deficit. These procedures were backstopped by automatic spending cuts that applied to precisely the same programs specified in the Gramm-Rudman law (basic low-income programs, but not Medicare, were exempt from sequestration), but unlike Gramm-Rudman, the BEA proved successful. Based on this experience, former Congressional Budget Office Director Robert Reischauer concluded that "budget procedures are much better at *enforcing* deficit reduction agreements (as the BEA has) than at *forcing* such agreements to be reached (as Gramm-Rudman attempted to do)."[1] Lawmakers were intent on avoiding the automatic cuts. No one suggested that the threat could be ignored because the scope of programs subject to reduction was not sweeping enough.

Despite the failure of the Balanced Budget Act, proposals are again surfacing to change the budget process in an effort to force deficit reduction. For example, S. 245, introduced by Senator Corker, would limit federal spending to 20.6 percent of GDP, the average from 1970 through 2008. The spending levels of an earlier era, however, are inapplicable to the current budgetary situation, because they do not account for several fundamental changes in society and government: the aging of the population, substantial increases in health care costs since earlier decades, and new federal responsibilities in areas such as homeland security (following the 9/11 attacks), veterans' health care (including long-term obligations to care for those injured in Iraq and Afghanistan), and the prescription drug coverage for seniors that took effect in 2006.

The Corker bill would impose automatic, across-the-board cuts to close the gap between projected spending and the spending cap if the cap would otherwise be breached. If the cuts needed to reach the cap were achieved entirely through this mechanism, the estimated cuts would total about $1.3 trillion in Social Security, $860 billion in Medicare, and $550 billion in Medicaid just over the first nine years that the cap was in effect. Policymakers could avoid the across-the-board cuts by making specific cuts in specific programs to meet the spending cap, but to do so they would almost certainly have to enact the kinds of radical changes in Medicare and Medicaid and deep cuts in other programs that are included in the budget resolution the House passed on April 15. Indeed, CBO estimates that if all of the cuts in that budget were instituted, federal spending in 2030 would be 20¾ percent of GDP, a little *above* the Corker cap. Other proposals, such as S. J. Res. 10, would limit spending to even lower levels and would have even more severe consequences.

Placing such a cap on total spending would essentially absolve revenues — including tax expenditures — from playing any part in the effort to bring long-term deficits under control. In fact, it would encourage the conversion of spending programs into tax expenditures, which would not count against the cap. And it would favor subsidies provided through the tax code (which generally favor corporations and high-income individuals) over other forms of assistance (which primarily benefit low- and moderate-income people).

Imposing an arbitrary limit on federal spending would risk tipping faltering economies into recession, make recessions deeper, and make recovery from a recession more difficult. Spending for some important federal programs — including unemployment insurance, food stamps, and Social Security — increases automatically during a recession, when the need for assistance grows. Since GDP also shrinks during a recession and remains below its trend level during the early stages of

[1] Robert D. Reischauer, Director, Congressional Budget Office, Statement before the Subcommittee on Legislation and National Security, Committee on Government Operations, U.S. House of Representatives, May 13, 1993. Emphasis added.

recovery, federal spending increases significantly as a share of GDP during periods of economic weakness. This automatic response softens the recession's blow not only for the programs' beneficiaries but also for the economy as a whole by maintaining total purchasing power. Attempting to limit federal spending to a fixed share of GDP would "impinge on the stabilizers on the spending side of the budget," as CBO Director Douglas Elmendorf testified earlier this year. Taking away these stabilizers, Elmendorf warned, "risks making the economy less stable [and] risks exacerbating the swings in the business cycle."[2]

A global spending cap would also make it virtually impossible to address emerging issues such as climate change. Limiting the emission of greenhouse gases either by auctioning emission allowances (a "cap-and-trade" system) or by imposing a tax on carbon would generate *revenues* for the federal government. Much of these revenues would have to be used for related *expenditures*, such as offsetting the higher energy costs of low- and moderate-income consumers, financing increases in energy efficiency, and funding research into alternative sources of energy. Even though a climate-change bill would be deficit-neutral, under a global spending cap that would be irrelevant. Every new dollar of spending to combat climate change would require a cutting a dollar of spending in other programs — in addition to the deep cuts that would be required in any event. A spending cap would thus make climate-change legislation virtually impossible to pass.

Former Senator Pete Domenici and former Office of Management and Budget Director Alice Rivlin, co-chairs of the Bipartisan Policy Center's deficit-reduction task force, recently proposed a more promising budget enforcement process that they dub "save-as-you-go," or SAVEGO.[3] SAVEGO expands on the discretionary spending caps and pay-as-you-go procedures of the 1990 Budget Enforcement Act in a way intended to prompt policymakers to agree on the policy changes necessary to put the federal budget on a sustainable path.

Under SAVEGO, the President and Congress would establish a future debt-to-GDP target and a path to achieve it. Then, the debt-stabilization path would be translated into annual deficit-reduction amounts for separate categories of spending and revenues. If Congress failed to achieve the necessary savings, SAVEGO would impose automatic spending cuts and reductions in tax expenditures or other revenue increases within each category.

A plus of SAVEGO is that it would require specific amounts of budgetary savings, which are under the direct control of policymakers, rather than setting deficit or debt targets (as in Gramm-Rudman), which can shift when the economy or other factors change. It thereby avoids harming the economy by requiring larger budget cuts or tax increases when the economy weakens and smaller ones when the economy is strong.

Another positive aspect of SAVEGO is that the automatic changes would affect both spending and revenues. If an automatic mechanism affected mandatory programs but not revenues, reaching a deficit-reduction agreement would become less likely, since opponents of a deficit-reduction agreement that included revenues could achieve their goal simply by sitting on their hands.

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[2] Douglas W. Elmendorf, Director, Congressional Budget Office, Transcript of Testimony before the Senate Budget Committee, January 27, 2011, Federal News Service.

[3] Bipartisan Policy Center, *How SAVEGO Would Work*, April 13, 2011, http://bipartisanpolicy.org/sites/default/files/How%20SAVEGO%20Would%20Operate%20(4-28-11).pdf.

Moreover, SAVEGO would not necessarily limit the automatic changes affecting revenues to changes in tax expenditures, since it may prove difficult to design automatic cuts in tax expenditures in a way that would raise sufficient revenues.

Although aspects of the SAVEGO proposal raise concerns and would need modification, they can be addressed without changing the basic concept, which deserves consideration. In particular, the proposal does not explicitly provide for the exemption of low-income programs from sequestration, as has been the case under Gramm-Rudman and every one of its successors. It is essential that these exemptions be maintained in SAVEGO or any new budget enforcement legislation. As many of our nation's religious leaders have recently reminded us, "The nation needs to substantially reduce future deficits, but not at the expense of hungry and poor people."[4] There is no evidence that exempting low-income programs from sequestration weakens the enforcement mechanism; the exemption was part of the pay-as-you-go regime of the 1990s, when it proved a great success.

In conclusion, the history of the budget process suggests that it is difficult to design automatic mechanisms that will force agreement on actions to reduce the deficit. As Congress considers what steps to take next, it should learn from that history and avoid repeating the mistakes of the past.

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[4] Leith Anderson, President, National Association of Evangelicals, and others, *A Circle of Protection: A Statement on Why We Need to Protect Programs for the Poor*, April 27, 2011, www.circleofprotection.us.

<u>Questions for Dr. Paul Van de Water</u>
Finance Committee Hearing on Budget Enforcement Mechanisms
May 4, 2011

<u>Questions from Senator Baucus</u>

1. Under a spending cap, there is likely to be very little, if any, deficit reduction through revenue increases. This would generally lead to deeper and more painful spending cuts, all other things being equal. Do you agree that this is a major disadvantage of spending caps?

   Yes, the spending level of an earlier era doesn't accommodate the fundamental changes in society and government in recent years: not just the aging of the population and rising health care costs, but also new federal responsibilities in areas such as homeland security (after 9/11), prescription drug coverage for seniors, and health care for veterans of Iraq and Afghanistan. As a result, it would be simply impossible to maintain federal spending at its historical average without slashing Social Security, Medicare, Medicaid, and an array of other vital programs. A balanced approach to deficit reduction—one that includes substantial revenues—is essential.

2. Gramm-Rudman-Hollings and pay-go have safety valves that can turn off the across-the-board cuts in spending and tax expenditures if there is an economic downturn. The President's proposal has a safety valve too. Do you believe that this is a good idea?

   It's a good idea in theory, but in practice it's very difficult to design a safety valve that would be both simple and effective. An economic downturn drives the federal budget off course for many years. For example, the most recent recession technically ended in June 2009, but the downturn is still adding substantially to the deficit and will continue to do so for several more years. Any safety valve should operate automatically and allow for recalibrating the entire target path of deficits and spending in the wake of a downturn.

3. The McCaskill-Corker global spending cap would limit total annual spending to 20.6% of GDP in a few years. I know that you have done some numerical analysis of this spending cap.

   If Social Security, Medicare, and Medicaid are not exempt from across-the–board spending reductions, isn't it true that these three programs would be subject to deep spending cuts, or if these three programs were exempt from across-the board spending cuts, then there would be extremely deep cuts in the remaining mandatory spending programs and in discretionary spending, including defense?

   If the cuts needed to reach the cap in the Corker-McCaskill bill were achieved entirely through the bill's automatic spending-reduction mechanism, Social Security, Medicare, Medicaid, and other mandatory programs all would be cut 19 percent in 2021. The cumulative cuts from 2013 through 2021 would total $1.3 trillion in Social Security, $856 *billion in Medicare, and $547 billion in Medicaid. There is little possibility that Social Security, Medicare, and Medicaid all would be exempted from cuts, since doing so would require cutting everything else by unthinkable amounts.*

4. Health Programs Exempt From Trigger
   - Can you describe what federal health care programs were exempt from previous sequestration proposals?
   - How is that different from what the President has proposed?
   - What factors should Congress examine as we decide whether to exempt certain health care programs?
   - What recommendations do you have for programs, particularly those for vulnerable Americans that should be exempt?

Up to now, sequestration laws have all exempted low-income mandatory programs, including Medicaid, the Children's Health Insurance Program, and refundable tax credits. In designing any sequestration mechanism, the Congress should continue these longstanding exemptions for low-income programs and should update the list to include any low-income programs that have been enacted recently. The President's proposed "debt failsafe" would also not apply to low-income programs.

COMMUNICATION

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STATEMENT FOR THE RECORD

SUBMITTED TO THE

SENATE FINANCE COMMITTEE

on

Budget Enforcement Mechanisms

May 4, 2011

AARP
601 E Street, N.W.
WASHINGTON, D. C. 20049

For further information, contact:
Nora Super
(202) 434-3770
Government Relations & Advocacy

On behalf of our members and all Americans age 50 and over, AARP appreciates the opportunity to submit comments on federal budget enforcement mechanisms and their impact on current and future retirees. AARP believes that the nation's long-term debt requires attention and we are committed to lending our support to a balanced approach that addresses the nation's long-term fiscal challenges. However, in addressing these challenges, we must not lose sight of the need to protect vital programs such as Social Security, Medicare, Medicaid, and other important programs that older Americans rely on every day for their health and retirement security.

From surveys, town hall meetings, ongoing correspondence and numerous other interactions, we know older Americans are deeply concerned about the deficit and our nation's fiscal health. However, they also want to make certain the promises made to them regarding Social Security and Medicare -- which help them plan for and gain a measure of security in their retirement -- are kept both for them and for their children and grandchildren.

Today's older Americans have contributed a great deal to our society throughout their lives. They have helped to build our nation through employment, paying their taxes, raising families, and contributing to their communities as leaders, mentors, military service men and women, and volunteers. Millions of them are still very active members of their communities today – whether they are paid or unpaid – contributing countless hours to charitable efforts or helping to care for their friends and loved ones in their own homes.

Older Americans truly understand that budgets matter and that we all need to live within our means. But they also understand that budgets impact real people – federal programs can make meaningful differences in peoples' lives and help ensure that older and disabled Americans can live independently and with dignity as they age. We urge that any proposals under consideration distinguish between: programs whose benefits serve an important need from those programs that do not; programs that have been contributed to and earned over the course of a lifetime and those that are not; and programs that are wasteful and inefficient and steps to either eliminate them or make them more efficient. For example, AARP generally opposes proposals that result in arbitrary, across-the-board, spending cuts that fail to distinguish between different types of spending and would take a meat ax approach to governing. AARP believes that solutions to our nation's long-term financial challenges should be thoughtful and balanced, not arbitrary and across the board. Importantly, efforts to rein in the debt and deficit should not harm critical Social Security, Medicare and Medicaid benefits which are essential to the retirement and health security of current and future retirees.

Social Security

AARP strongly believes that Social Security, a self-financed program important to both current and future generations of Americans who pay into the system, should not be cut in any effort designed to achieve arbitrary overall federal spending targets.

Social Security benefits are financed through payroll contributions from employees and their employers, each and every year, throughout an individual's working life. The program is separate from the rest of the federal budget and has not contributed to our large deficits. According to the Social Security Trustees, the program has sufficient assets to pay 100 percent of promised benefits for over a quarter century, and even with no changes, can continue to pay approximately 75 percent of promised benefits thereafter. While Social Security faces this long-term shortfall, targeting it now for arbitrary, across-the-board cuts is unfair and unnecessary, and will most assuredly mean significant reductions in benefits for not only current beneficiaries, but for their children and grandchildren as well.

Social Security is currently the principal source of income for nearly two-thirds of older American households receiving benefits, and roughly one third of those households depend on Social Security benefits for nearly all (90 percent or more) of their income. Despite its critical importance, Social Security's earned benefits are modest, averaging only about $1,200 per month for all retired workers in March 2011. Nonetheless, Social Security keeps countless millions of older Americans out of poverty and allows tens of millions of Americans to live their retirement years independently, without fear of outliving their retirement income. Social Security also provides critical income protection for workers who become disabled, and for the families of workers who become deceased. Moreover, while personal savings should always play an important role in retirement planning, with the growing prevalence of 401(k) and other individual account plans and the decline in defined benefit pension plans, the guaranteed benefit of Social Security will become increasingly important to future generations as workers live longer and bear more of the market risk associated with investing for their own retirement income.

Given the already modest benefits current Social Security beneficiaries receive, the program's continued critical importance to future generations' income and retirement security, and the system's dedicated financing, AARP firmly believes that Social Security should not be targeted for cuts as part of a budget exercise to satisfy arbitrary spending thresholds. More importantly, in the face of declining pensions, shrinking savings, and longer life expectancies, Social Security deserves to have its own national conversation that focuses on preserving and strengthening the retirement security of Americans and their families for generations to come.

Medicare

As the Committee – and other Members of Congress – continues to grapple with proposals to address this country's long-term deficit, AARP urges you to reject proposals that simply shift health care costs onto Medicare beneficiaries and do not address the underlying problem of rising health care costs throughout the system.

It is a fact that all health care costs, including Medicare costs, have been increasing at levels above inflation each year. This trend is not sustainable. However, Medicare is just one part of our nation's health care system, which includes a vast array of other payers including public, individual, and employer-based health insurance. Focusing only on Medicare (and Medicaid) and enacting arbitrary limits and/or across-the-board cuts to the program will not rein-in overall health care cost growth. These arbitrary cuts to Medicare simply shift costs on to other payers of health care services, particularly beneficiaries and their families, and undermine current and future beneficiaries' access to quality care.

AARP believes that if we are serious about addressing rising health costs, we cannot only look to Medicare (and Medicaid) for solutions. There are steps we can take to improve the Medicare program -- including increasing preventive services, lowering the costs of prescription drugs, and encouraging delivery system reforms that improve care coordination for beneficiaries -- that should help to reduce the growth in health costs for the overall program. And there are steps we can take to further reduce waste in the program. However, to truly tackle the issue of rising health care costs, we urge you to focus on changes that will incent high value care and reduce waste, fraud, and inefficiency that occurs throughout the entire health care system. While Medicare (and Medicaid) can play an important role in improving the delivery of health care, targeting federal programs alone is short-sighted and will not reduce overall health costs.

Over 47 million older Americans and Americans with disabilities depend on Medicare today. And as you know, significant savings related to the Medicare program have already been enacted as part of the Affordable Care Act (ACA). AARP's support for this law was based in part on many of the delivery system reforms—such as Accountable Care Organizations (ACOs), patient-centered medical homes, value-based purchasing, quality-based payments, and patient safety initiatives – included in the law. We have been working closely with providers, physicians, and health plans to help ensure that these delivery system reforms are implemented in such a manner that current and future beneficiaries benefit from both a higher quality and more efficient Medicare program.

However, we believe implementation of these significant delivery system reforms will take time, planning, and commitment from Congress, the Administration, and providers to help achieve a new way of delivering care: one that focuses on improving primary and coordinated care for beneficiaries, and payment incentives that reward quality and improved outcomes rather than volume. AARP believes setting annual, arbitrary cost targets for Medicare will undercut this needed progress, and we strongly urge Congress not to enact such counterproductive measures.

The new law already includes an Independent Payment Advisory Board (IPAB) which, although it contains some important consumer protections, could potentially trigger cuts that may impact seniors' access to care. During the health care debate, AARP raised concerns about the arbitrary IPAB targets, and the role of an unelected and unaccountable board. We have also continued to point out the shortcoming of any strategy that singles out Medicare instead of targeting waste, inefficiency and delivery system reform throughout the health care system.

While IPAB is charged with looking at access and provider payment policies in the broader context of health system trends, we remain extremely concerned expanding IPAB could have a negative impact on Medicare beneficiaries' access to care. We do, however, strongly urge Congress to maintain the consumer protections supported by AARP – including prohibitions on cutting benefits, raising seniors' already high out of pocket costs, and rationing care -- enacted as part of IPAB.

Medicaid

A recent AARP study finds that 9 out of 10 Americans 50 plus want to stay in their current residence for as long as possible – and many need the support of Medicaid, the primary payer for long-term care, to retain this independence. Arbitrary limits on Medicaid could deny many Americans that right to choose how and where they receive the long-term care they need. Medicaid helps pay for a large percentage of nursing home care as well as home- and community-based services. Because of the extremely high cost of long-term services and supports (for example, the average annual cost of a nursing home stay is over $70,000), many older Americans, even middle class Americans, have had to virtually deplete all of their resources to finance their care. Medicaid is a last resort for these families, providing a lifeline to continue to receive the services and care they need.

AARP is concerned that putting unfair limits on Medicaid could reduce access and quality care, such as cutting staffing in nursing homes, which could put the health and safety of our seniors and people with disabilities at risk. It would also reduce access to much needed and preferred home and community-based services. Arbitrary limits could also mean cuts to support for family caregivers (both paid and unpaid) who provide needed services and supports for seniors and adults and children with disabilities to help keep them living in their homes and communities for as long as they can. Cuts could also include services, such as respite care, that allow unpaid caregivers a short reprieve from their caregiving duties, and likely saves the Medicaid program millions each year across the states.

As you examine how to address the growing costs of health care programs, we urge you to reject arbitrary limits, and focus instead on ways to make the delivery of health care to all Americans more efficient and cost-effective.

Conclusion

On behalf of our millions of members and all older Americans, we appreciate the opportunity to share our views on this important debate. We urge Congress to not simply look at the numbers in the budget, but the real people that would be impacted by these budget driven changes and enforcement mechanisms. Literally, millions of people are counting on you. We look forward to working with Members of this Committee, as well as Members from both Houses of Congress and both sides of the aisle, to craft legislation that will address our nation's long-term debt without sacrificing the current or future health and retirement security of our nation's seniors.