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INFORMED BUDGETEER

SOS ACT OF 2006 – NOT YOUR FATHER'S BUDGET REFORM

- Over the past decade, there has been a lot of talk about budget process reform – but little action. The Stop Over-Spending (SOS) Act of 2006 (S. 3521) represents the first significant effort in the Senate to comprehensively reform the federal and Congressional budget process since the 1990 Budget Enforcement Act. This legislation provides a blanket approach to controlling federal spending through short- and long-term solutions designed to control the rate of growth in mandatory spending and keep discretionary spending within legislated limits.

- Of all the titles in S. 3521 (legislative line item veto/expedited rescission, biennial budgeting, program reform commissions), the one that may be most unfamiliar to *Bulletin* readers is Title II (Deficit Reduction), since it is somewhat complicated and represents variations on spending control mechanisms of the past (see table below). For this reason, this article focuses on Title II. Readers are encouraged to refer to Senate Report 109-283 for a complete review of S. 3521.
http://budget.senate.gov/republican/pressarchive/SOS/2006-07-17SOSCommitteeReport.pdf

COMPARISON OF BUDGET ENFORCEMENT LEGISLATION

	Gramm-Rudman-Hollings (1985-1990)	Budget Enforcement Act (1990-2002)	Title II of Stop Over Spending Act of 2006
Deficit Target	defined in specific nominal dollars (billions)	no deficit target enforceable with automatic reductions; instead, enforcement actions triggered off of future Congressional action, not deficit levels resulting from current law	defined as a declining percentage of GDP in each year
Discretionary Caps Set in Law?	No	Yes	Yes (2007-2009)
Enforcement Mechanisms – Discretionary	across-the board reductions (sequester) of programs that are not exempted, split 50-50 between defense and nondefense programs (applied equally to both appropriated and direct spending accounts)	across-the board reductions of discretionary budget authority and outlays that exceed caps	across-the board reductions of discretionary budget authority (only) that exceeds caps
Enforcement Mechanisms – Mandatory	across-the board reductions (sequester) of programs that are not exempted, split 50-50 between defense and nondefense programs (applied equally to both appropriated and direct spending accounts)	across-the board reductions of mandatory programs (except a large number that are exempt) if Congress enacts new direct spending or tax cuts without an offset (PAYGO)	automatic reconciliation required if deficit target is exceeded; if that fails, then across-the board reductions of mandatory programs (except Social Security and a small number that are exempt) occur

- Title II of the SOS Act has been the subject of unfounded criticism. Believe it or not, some are saying that Title II will not work because it represents retreads of old ideas and mechanisms that failed. Granted, SOS shares some similarities with the statutory discretionary caps of the 1990s (enacted in the Budget Enforcement Act, BEA, which the "conventional wisdom" partially credits for the surpluses at the end of that decade) and the deficit targets of the Gramm-Rudman-Hollings (GRH) law in the latter half of the 1980s. But the Deficit Reduction title of the SOS Act goes much farther by retaining elements of what worked before and improving on ideas that left room for improvement.

- Informed budgeteers know that the primary criticism of GRH was that the fixed deficit targets were evaded (and a balanced budget was not achieved) due to "budget gimmickry," such as low-balling the estimated deficit (to be close to the deficit target, so that large reductions through sequestration would not be ordered), promising reconciliation savings that were never achieved, and resetting the targets when it became clear that they were unachievable.

- When asked to testify before Congress regarding the budget process, CBO Directors Reischauer (in June 1992) and O'Neill (in July 1995) took into account the experience with GRH and BEA and recommended four principles for an effective mechanism to enforce a path to a balanced budget:

1. The mechanism for enforcement should encourage agreement on policy actions to reduce the deficit, without having to resort to automatic, formula-based solutions.
2. Participants in the budget process should not be held accountable for those events that are beyond their direct control.
3. Opportunities to evade the balanced budget rule and to distort policies in response to the rule should be minimized.
4. The legislation should, to the extent possible, maintain the flexibility necessary for managing the economy and responding to national emergencies.

- Title II of S. 3521 reinforces the fact that the first line of responsibility for deciding how to reduce spending still lies with Congress and the President, reflecting the first principle listed above. While reconciliation was a tool frequently used to reduce spending in the 1980s, it was used less in the 1990s (four times successfully; one bill was vetoed), and, until this past year, had not been used to reduce spending since 1997.

- One of the barriers to deficit reduction has been the difficulty of getting the votes to report reconciliation instructions in a budget resolution out of the Budget Committees and maintaining those instructions during floor debate and through a successful conference on a budget resolution. Title II would make it possible to consider legislation that reduces mandatory spending under the privileged rules of reconciliation without having to get the votes for it in a budget resolution. Once the Congress is notified that the deficit is going to be larger than the target, the Budget Committees would issue reconciliation instructions (proportional to a committee's jurisdiction) and have the tools to bring into compliance on the floor those committees that do not comply.

- Next consider CBO's second principle that decisionmakers "should not be held accountable for those events that are beyond their direct control." In the late-1980s, annual deficits tended to be higher than had been "expected" because of short-term changes from higher spending and lower revenues. It is likely CBO was suggesting that Congress and the President should not be held accountable for fiscal effects resulting from simply allowing economic fluctuations or changes in how existing programs were implemented to flow through current law (especially if Congress had not enacted any new law to make the problem worse; this is why paygo was invented to replace GRH).

- But CBO probably did not intend for its statement to absolve Congress and the President from all responsibility for all the future fiscal effects of all current-law policies on the books, no matter how overpromised our nation's resources might be. At some point, decisionmakers have an obligation to evaluate whether existing law is sustainable. And unlike GRH, whose declining deficit targets established an immediate day of reckoning, Title II's deficit goals give Congress several years to come to grips with the future fiscal effects of mandatory programs, which are within Congress' direct control.

- Putting automatic reconciliation (which is only "backed up" by sequestration) front and center addresses the second principle listed above by placing the responsibility for over-spending on members. They have direct control over the legislation in the jurisdiction of the committees to which they belong and can target the structural reforms needed to get spending down over the long term better than any across-the-board reduction.

- The provisions of Title II address the second, third and fourth principles listed above because the SOS deficit targets float with the size of the economy rather than fix in law a deficit target as a specific dollar value. It is possible that the economy will perform better than expected. This means that the deficit target could be easier to meet in terms of spending reductions that would have to be enacted. If the economy were to grow faster than currently expected, then gaming the system would not be as tempting. If, however, the economy were to slow down, then the deficit targets, expressed as a percentage of GDP, could bite harder. In this case, the Congress would have the responsibility to pinpoint the required reductions on spending programs that would not have as much of a detrimental effect that across-the-board reductions would have on counter-cyclical programs.

- If the economy is in such doldrums that the indicated spending reductions -- whether auto reconciliation or sequester -- would not be advisable, Title II includes the option for Congress to suspend these procedures when it has been notified by CBO that the economy is in a low-growth situation (low growth is defined as two consecutive quarters of actual economic growth of less than one percent in real terms reported by the Commerce Department, or two consecutive quarters where either CBO or OMB projects future, real economic growth to be less than zero).

- Alternatively, if Congress judges that sufficient spending reductions are not advisable and cannot be enacted to reach the deficit target due to any combination of factors (such as unforeseen emergencies, war, or poor economic growth), and if the low-growth option is not available to Congress, the backup mechanism of sequestration could be turned off by an act of law -- Congress and the President always have that option and have used it in the past, and this option would once again be available under Title II.

- Title II of SOS differs from past efforts to reform the budget process in several other important ways. It places an emphasis on dealing with the budget realities of 2006 (instead of the budget situation in 1990 when the savings and loan crisis dominated federal deficits) by (1) emphasizing the need to deal with entitlement spending, which is the greatest threat to our future financial security, and (2) controlling both regular and "emergency" discretionary spending.

- Currently, entitlement programs are largely on automatic pilot and are growing, without controls or limits, much faster than the Nation's ability to pay for them. Title II's emphasis on Congressional action (via reconciliation) to reduce mandatory spending (with sequestration as a backstop) will force Congress to examine all entitlement programs and adopt the prudent structural reforms needed to get spending under control over the long term.

- Regarding the rest of federal spending on the discretionary, annually-appropriated side of the ledger, Title II sets statutory limits on discretionary budget authority for three years: 2007, 2008 and 2009, with any breach of the limit enforced by an across-the-board sequester. This differs somewhat from the last effort (in 1997) to set discretionary caps for five years, which proved to be ineffective due to the difficultly of estimating spending needs too far into the future. The legislation also addresses the abuse of the existing "emergency" spending loopholes. With increasing frequency and in increasing amounts, Congress and the President have funded predictable, annual expenses through emergency appropriations. Exceeding both the regular and the emergency spending caps would trigger sequestration of discretionary funds.

MID-SESSION REVIEW

- On July 11, OMB released its Mid-Session Review of the President's Budget for 2007. The President's Budget request in February estimated that the deficit for 2006 – assuming all the President's proposals were enacted – would be $423 billion. The Mid-Session Review reflects OMB's latest estimate of what future deficits will be, taking into account all legislation enacted since February and assuming all remaining proposals in the President's budget will still be enacted. For 2006, OMB now estimates the deficit will be $296 billion, which is $127 billion lower than it estimated in February. Stronger-than-expected growth in revenues is primarily responsible for the improved deficit outlook. See the table below for additional details.

- Also of significance, in addition to the $50 billion requested for 2007 in the President's budget, OMB's Mid-Session includes another $60 billion to fund the Global War on Terror in 2007, bringing total anticipated war costs to $110 billion in 2007. Emergency spending in the Senate is limited to $86.3 billion in 2007, pursuant to the "deemer" included in the June supplemental appropriations bill. Further, as a placeholder, OMB now includes $50 billion for the war in 2008.

Changes to 2006 deficit projection in OMB Mid-Session Review
($ in billions)

	2006
2006 proj. deficit in Pres. 2007 Budget - Feb. 2006	**-423**
as a percent of GDP	-3.2%
Economic and technical changes	121
Receipts	*107*
Increase in individual income taxes	*60*
Increase in corporate income taxes	*53*
Decrease in other taxes	*-6*
Decrease in outlays	*15*
Policy changes	6
Higher outlays resulting from enacted 2006 supplemental above President's budget request	*-2*
Lower revenues resulting from enacted tax reconciliation compared to tax proposals in President's budget	*-6*
Smaller revenue loss compared to President's February revenue proposals, as adjusted for revenue legislation enacted thus far	*14*
Other	*-1*
Total change	**127**
2006 proj. deficit in Mid-Session Rev. - July 2006	**-296**
as a percent of GDP	-2.3%

NOTE: Details may not add to totals due to rounding.