BIPARTISAN POLICY CENTER

Q&A on SAVEGO
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Why did we choose to target an explicit amount of annual budget savings, rather than the actual ratio of the debt to the GDP?

The basic reason is that annual budget savings can be controlled directly by the Congress through the enactment of spending bills and changes in tax and entitlement legislation. Because the Congress can control that objective, it can be held responsible if it fails to meet it. By contrast, neither the debt nor the GDP can be controlled by act of Congress. Both are affected by the ups and downs of the economy, wars, natural disasters, and other factors outside direct congressional control. If the Congress is whipsawed by uncontrollable factors, it will waive the law, and the process will lose credibility and break down.

There is a close analogy between our decision now and the choices that were taken with the enactment of Gramm-Rudman-Hollings (GRH) in the 1980s, and then the Budget Enforcement Act (BEA) in 1990.

GRH targeted the size of the budget deficit. One argument for that approach was that the deficit was the number that was the object of concern at that time. A second argument was that the public would understand the deficit as a target of policy.

However, the strict, inflexible deficit targets of GRH failed – though Congress learned from the experience and they were replaced after five years. GRH had many problems, but perhaps chief among them was that policymakers could not be held responsible for hitting a target that they could not control. When things went wrong and the budget missed the deficit target, the Congress and the President were loath to go back and fight their way up the budget hill again.

In contrast, the successor to GRH, the BEA of 1990, targeted amounts of budget savings rather than the deficit itself. The 1990 BEA was highly successful, helping to improve the budget from the largest deficit to the largest surplus in history.

The design of an initial budget bill under SAVEGO can be exactly the same as under a debt or deficit target – the choice of a disciplinary mechanism will not influence the plan itself. In each case, the Congress would start with the ultimate debt target, determine the budget savings needed to hit that target, and then choose the actual budget policies needed to do so. So there is no reason to expect that the actual policy plan would be any different under the two goals.

But what if the economy weakens and your policy changes fall short?

There are two possible ways in which that could happen:

(A) Suppose that the economy has a ***temporary*** hiccup from which it will recover. Under SAVEGO, if the Congress achieves the target budget savings, there is no requirement to go back and achieve

additional savings – ***which could worsen the downturn***. When the economy recovers, the budget and the debt should be back on track. Under a debt target, however, the Congress would be obliged to attain additional savings or allow a sequester. This would hit a weakened economy again, and might make the downturn worse. If the Congress chooses – arguably wisely – to waive the requirements of the law under such a debt target, it could weaken the law's credibility.

(B) Alternatively, the economy could weaken structurally, and therefore underperform the initial economic assumptions ***on a continuing basis***. Some might think that the debt target would work better under those circumstances because it would force the Congress to readdress the situation each year. However, it will take time to know for sure whether the economy has slowed for an extended period, or is just in a temporary funk. For that reason, after the Congress cuts trillions of dollars to comply with a deficit-reduction plan, it would be wise to give the economy some time to digest those savings and get back into normal operation. It is possible that the action taken by the Congress to comply with SAVEGO will be enough to achieve our debt target, though a few years late. Under that circumstance, it might be better to declare victory and leave well enough alone, rather than to reopen the issue and perhaps hurt the economy. Realistically, though, if economic growth really does slow significantly for an extended period, policymakers will need to review the budget in a fundamental way no matter what the budget process is. (This possible eventuality is another reason why the Congress should use prudent, rather than optimistic, economic assumptions to plan the budget.)

On the other hand, economic news is not necessarily bad. ***The economy could do better than projected, rather than worse***. Under that circumstance, SAVEGO has a distinct advantage. With a debt target, an upward blip in the economy would create an instant "party fund." The Congress could renege on past deficit-reduction action, and increase spending and cut taxes. If the improvement in the budget outlook proves to be only temporary, though, such a party could be a serious mistake – and this nation has a history of prematurely declaring victory against the budget problem.

Addendum: Some Other Issues with a Debt-to-GDP Ratio Target

Although the vast majority of economists and budget experts would agree that the overall objective of budget policy should be denominated in terms of the ratio of our nation's debt to its GDP, the use of the debt-to-GDP ratio as a trigger in the budget process raises important issues.

A trigger using the debt-to-GDP ratio might seem straightforward and understandable to some. In fact, the BPC's Debt Reduction Task Force and the President's Fiscal Commission decided that its ultimate goal was to reduce and stabilize the ratio of the public debt to the GDP. Why use anything else as an enforcement trigger for the budget process? Upon examination, there are several reasons:

First, we do not know the actual public debt until ***after the end of a fiscal year***. And second, we do not know the GDP for that fiscal year until ***even later***. The first estimate of the GDP in the last quarter of a fiscal year comes almost one month after the end of the fiscal year. The "final estimate" does not come until almost three months into the next fiscal year. And there are more revisions that follow. About every five years, the Bureau of Economic Analysis undertakes major revisions of the national accounts that can change the estimates of the GDP as far back as ***1929***.

Which raises a question: Just how do you enforce a budget process with a debt-to-GDP-ratio trigger? Suppose that the debt and GDP are near the borderline between compliance and noncompliance. When does the "umpire" decide? After the first estimate of GDP – that is, one month after the end of the fiscal year? Or after the "final" estimate, three months after the end of the fiscal year (with the understanding that the GDP number actually will ***never*** be truly "final")?

Then, suppose that the debt is deemed to have exceeded the target. The next fiscal year will already be underway. When will the Congress take corrective action? Because savings will be difficult to achieve partway through a fiscal year, will action be postponed until the succeeding fiscal year? If so – and this would seem the most appropriate and workable option – then the remedy will follow the violation by one full fiscal year – rendering any supposed advantage of timeliness under the debt-to-GDP-ratio trigger rather weak. And even if the Congress (or the automatic sequester) were required to take action effective immediately, the savings that could be achieved in the part of the fiscal year remaining after a determination of noncompliance could well be trivial relative to a potential shortfall.

The GDP is now approaching $15 trillion. Therefore, under a trigger based on the ratio of the debt to the GDP, a GDP estimating error of 1 percent would change the permitted amount of spending and/or taxes by about $150 billion. For perspective, both the Congressional Budget Office and the Office of Management and Budget have an average absolute forecasting error, two years ahead, of more than one percent. How much is $150 billion? It is more than one-third of annual non-security appropriated spending. It is well over half the annual cost of extending the 2001 and 2003 tax cuts. Sending the Congress and the President misleading signals of this magnitude – sometimes one way, sometimes the other way – and requiring such changes of policy in real time could have seriously damaging consequences.

This is part of the reason why we chose SAVEGO, which requires an amount of budget savings for each fiscal year that is determined well ahead of time by law, rather than a using a constantly variable trigger based on the ratio of debt to GDP. And specifically, we doubt whether a malleable concept such as the GDP possibly could be used as part of a legally enforceable budget process.