Comparative Budget Policy:

Lessons for Reform in the United States

Conference Report
May 8-9, 2014
Program on American Democracy in Comparative Perspective
Center on Democracy, Development, and the Rule of Law
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For Public Release on October 1, 2014

Introduction

On May 8-9, 2014, the Program on American Democracy in Comparative Perspective at Stanford University hosted a workshop on comparative budget policy. The aim of the workshop was to bring together academics and policymakers from the United States and abroad to understand, and devise ways to improve, American budgetary politics. Representatives from the World Bank, the International Monetary Fund, and the Organisation for Economic Co-operation and Development spoke about ways to assess the American budgeting framework in comparative perspective, using benchmarks and indices of best practices. Practitioners and political officials from Japan, Canada, Australia, and Italy spoke about budgetary disputes and solutions in their countries. Policymakers and lawyers from the Office of Management and Budget (OMB) and the Congressional Budget Office (CBO) in the United States reflected on the challenges they faced while in office, and on the potential for meaningful procedural changes to the budget process. Finally, a group of interdisciplinary scholars from history, political science, law, and public policy provided context and analytical frameworks for understanding budgetary politics.

The motivation for the workshop stems from the observation that the United States government routinely fails in one of its foremost tasks: to create, and to pass, budgets. Congress often fails to devise a budget—in many years, it passes Continuing Resolutions to extend the previous year's budget, punting difficult decisions about which federal programs to cut, maintain, or grow. Even worse, the failure of the President and Congress to reach agreement on the budget has led to 18 government shutdowns since 1978, while shutdowns have remained rare in other advanced democracies.

In 2013, budget negotiations in Congress stalled multiple times as Republicans and Democrats failed to agree on a host of political issues, including the debt ceiling, funding of the Affordable Care and Patient Protection Act, and tax rates. These negotiations resulted in budget sequestration of many federal programs, and threatened to reduce the United States credit rating. As the fiscal year deadline of October 1 approached, both chambers of Congress tried to pass budget legislation to fund the government. Economists and experts predicted that failing to meet the deadline would have significant consequences, including a potential default on government debt. Despite these dire warnings, however, the parties failed to reach agreement, culminating in a 16-day shutdown of the federal government from October 1-16, 2014.

The objective of this workshop was to think through the causes of, and solutions to, ineffective budgetary politics and policy-making. This report begins by describing the politics of budgeting in the United States, and situates our procedural and political anomalies in the comparative context of budgetary politics around the world. The next section examines a range of suggestions to improve budgeting, from technical and procedural changes to broader institutional reforms. The report concludes by discussing the limitations of proposed reforms, and by thinking realistically about how to mobilize support for improved budgeting outcomes.

The Budgetary Process in the United States

Decisions about budgets are inherently fraught. In creating and passing budgets, governments must manage and mediate disparate demands, allocate scarce resources, and maintain economic discipline and solvency. Democracy further complicates the politics of budgeting, since citizens often desire a difficult combination of transparency, accountability, and efficiency in budget-making. In the United States, budgets are a product of lengthy, and often acrimonious, negotiations across many arenas of government—within Congress, between the Congressional and Executive branches, and between federal and state governments.

The modern budget process was created in the twentieth century, but fiscal authorizations and appropriations date to the founding period. The Constitution says relatively little about the budget, specifying that no money can be drawn from the Treasury unless authorized by Congress, and further specifying that budgeting should be done through appropriations. The modern budgetary process was spelled out in subsequent framework legislation that detailed the rules and procedures governing the budgetary process. The Budget and Accounting Act of 1921 created the Office of Management and Budget, which coordinates funding requests and expenditures across executive agencies. It also created the Government Accountability Office to serve as a non-partisan agency to conduct research and analysis about the budget. The Congressional Budget and Impoundment Control Act of 1974 created the Congressional Budget Office, a non-partisan agency that reports to Congress.

The budget is laid out twice—first through authorizations, and then through appropriations. In brief, the President submits an annual budget to Congress that includes funding requests from all executive agencies and departments. Budget committees in the House and Senate then review the President's budget, and submit their own budget resolutions to their respective houses. After negotiations, Congress passes a concurrent resolution authorizing the budget. Congress does not have to pass a budget, nor does the President sign the concurrent resolution. However, Congressional committees then draft appropriations legislation based on authorizations in the budget report. This process is often quite lengthy, with Congress using a reconciliation process to require departments and agencies to revise their funding estimates. Once the House and Senate have agreed on appropriations legislation, it is sent to the President. If vetoed, or if appropriations bills are not passed, funds are not appropriated by the beginning of the fiscal year on October 1, and the government is shut down.

The institutional configuration of the United States, which is presidential, federal, and two-party, makes it unique relative to its counterparts in North America and Western Europe. Power over the budget rests with many different veto players, and negotiations take place within congressional committees, within executive agencies, and between representatives of the legislative and executive branches. This is quite distinct from advanced democracies with parliamentary systems in which the legislature is fused with the executive, and in which there tend to be multiparty, coalitional governments. In those countries, authority over the budget rests in the executive branch or the civil service, with fewer interbranch conflicts and less politicization over budgeting.

Perhaps unsurprisingly, the cumbersome nature of the budgeting process in the United States is detrimental to its effectiveness. The debt ceiling negotiations and government shutdown of 2013 immediately drew criticism from abroad, not only because budget instability in the U.S. spills over to foreign markets, but also because it revealed an inability to conduct even the most routine functions of government. The current budget process has improved over the past decade; the 2011 Budget Control Act imposed sequestration-reducing discretionary spending. The U.S. has also adopted pay-as-you-go rules so that increases in mandatory spending must be accompanied by spending reductions in other areas. The OMB and CBO also provide sophisticated fiscal projections and ten-year estimates.

Despite these improvements, the United States still has high annual deficits, a rising debt, an overly complicated tax code, and poor enforcement of budget policy. International institutions such as the IMF, World Bank, and Organisation on Economic Co-operation and Development find that the United States consistently ranks lower than other advanced democracies in budget performance, despite having the world's largest economy. Richard Hughes, of the IMF Fiscal Affairs Department, recently benchmarked the United States against G20 countries. The IMF found that overall, the United States ranked 8th (the second-worst of the advanced democracies) at delivering successful fiscal consolidations. While the U.S. has good institutions and rules for understanding fiscal challenges, it does a poor job developing and implementing plans. The United States is particularly bad at expenditure controls: while most countries stick to within 1-2% of their budgets, the U.S. deviates by about 6-7%.

Reforming the U.S. Budgeting Process

The United States is not the only country to experience protracted political battles over the budget, although other countries have been more successful in trying to mitigate or to depoliticize many aspects of the budget. The international community has also developed sophisticated ways to evaluate and to improve domestic budgetary politics. Looking to budgets in other countries helps us to understand the causes of bargaining failures over the budget, the politics of reforming the budget, and policy solutions that could be adopted by Congress.

This next section therefore considers reforms to the budget process from a comparative perspective. The first set of reforms suggests technical changes to the process itself. The second set of changes looks to the broader institutions that shape the incentives of politicians and bureaucrats, and considers institutional reconfigurations that may reduce politicization of the federal budget.

A. Technical Improvements to the Budgeting Process

Improving Estimates of the Budget

One way that countries have improved their budgeting process is by improving estimates of the budget itself. Jon Blondal and Phil Sinnett both point out that many countries have adopted fiscal prudency in their estimates of budget expenditures. They have done this in different ways, including moving from cash to accrual accounting and introducing legally binding fiscal objectives that make deviation very difficult. Some countries have switched to spending rules instead of debt or deficit rules. They have also developed better baseline models of growth, and use a variety of baselines to extend the timeframe of budgeting and to integrate many associated costs of existing programs. Changing baseline models allows for better budget forecasting, which helps to create accountability in the implementation phase of the budget.

Streamlining Budget Legislation

Richard Hughes of the IMF also suggested ways to make the budgeting process more efficient. Congress could unify the federal budget into a single appropriations bill, rather than passing separate ones for each area of the budget, and such a bill could include both mandatory and discretionary expenditures. This is similar to omnibus legislation, but would include more specific accounting for all aspects of the budget. Alternatively, the appropriations process could be streamlined so that politicians can only haggle over part of the appropriations bill each year. In Canada, politicians look primarily to short-term achievable targets and annual increments so that intractable political debates do not reoccur each year. The timing of budget legislation could also be changed such that budget parameters are debated in Congress in the spring, and bills that are passed in the autumn must remain within the constraints established in the spring. This is done in the Netherlands, where coalitional agreements lay out budget goals at the outset of each term, and constrain what politicians can negotiate for later in the legislative session.

Strengthening intergovernmental coordination and cooperation

Congress and executive agencies could also strengthen intergovernmental fiscal coordination between federal, state, and local governments to mitigate the shocks that occur when municipalities and states face bankruptcy or insolvency. In many countries, subnational governments contribute significantly to overall debt reduction, which is not the case in the United States. Municipalities often contribute instead to the growing debt of the national economy. Stuart Butler of the Heritage Foundation suggested that if states and localities could be incentivized to improve their budgeting, perhaps through experimentation with new rules, they could both provide models for the federal government and reduce their burden on the national budget.

B. Institutional Changes: Reconfiguring the Center of Authority in the Budget Process

To the extent that budget crises result from discrepancies in authorizations and appropriations, technical changes can help to ensure fiscal discipline and increase accountability. However, budgetary politics have also become a microcosm of the current political landscape, in which divisiveness and obstructionist tactics reign in Congress. Member of Congress use the budget as a source of partisan maneuvering in the permanent campaign for office. Joachin Wehner finds that Congress's power over the budget makes the United States an extreme outlier in comparative budgetary institutions; most countries centralize authority over the budget in the executive branch.

Providing the legislature with significant veto power (or, as is the case in the United States, almost exclusive veto power) is risky, because legislators face immediate electoral trade-offs when determining winners and losers of the budget. There are concentrated winners in the budget process—defense manufacturers, farmers, recipients of social welfare benefits. There are those who benefit through tax expenditures, such as homeowners, corporations, and those whose earnings are in capital gains. The politics surrounding the budget make legislators beholden to discrete interests; they are therefore reluctant to rationalize spending, or cut programs, or reconfigure the tax code. The rise of social media and the 24-hour news cycle place politicians under further scrutiny, and have reduced much of budgeting—which requires negotiation and compromise—to sound bites and ideological warfare. Going beyond technical fixes to the budget is important, since changing institutional arrangements can change politicians' incentives to negotiate.

Top-Down Budgeting

One way that countries have tried to overcome politicization of the budget is through top-down budgeting. By centralizing authority within institutions, top-down budgeting reduces the number of veto players in the budget process. This usually entails providing ministers with greater discretion over their budgets, and allocating lump sums to ministries rather than appropriating all funds in an agency ex ante. This works especially well in Parliamentary systems and Nordic countries with small ministries like Austria, the Netherlands, and Scandinavian countries.

Australia provides an example of top-down budgeting. For over twenty years, Australia faced budget crises due to splits within ministries. The head of the finance department would have to negotiate funds with each separate minister. But in the 1980s, Australia reformed this process by decided that the finance minister would simply dictate how much each department would receive, allowing departments themselves to debate actual policies and programs. Over the next two decades, an expenditure review committee coordinated between departments to ensure that ministry decisions were in accordance with the agenda of the budget as a whole.

Sweden also implemented top-down budgeting in the 1990s following a macroeconomic crisis in which Sweden's deficits were 13% of GDP. The Swedish government experimented with different reforms through the early 1990s to determine how best to centralize control over the budget. In the late 1990s, a coalition government introduced top-down budgeting by providing the Minister of Finance and the finance committee of the legislature with more authority, and by implementing stricter constraints in budgetary decision-making. Sweden also developed surplus targets and created formal rules in expenditure ceilings. These reforms were very successful; during the recent recession, Sweden, unlike many other EU countries, did not breach Maastricht ceilings.

In the United States, creating top-down authority would likely work through the transfer authority given to Cabinet officials. Boris Bershtyn and Keith Fontenot – formerly of the Office of Management and Budget and the Congressional Budget Office, respectively – noted that this transfer authority would give secretaries flexibility, but it would need to be standardized, since some secretaries currently have much more discretion than others (up to 7% of the budget in the Agriculture department is at the discretion of the Secretary, while only 1% of the Health and Human Services budget is discretionary). While more executive authority over the budget has the potential to streamline budgeting, centralization in any form—even only among Congressional committees—would help to overcome heterogeneous interests.

Delegation to Independent Agencies

Aside from giving the executive more power, another solution is to increase the capacity of independent, non-partisan agencies in the budgeting process. As Jon Blondal explained, many countries have strengthened independent fiscal institutions as a way to reduce the politicization of budgeting. In Canada and the Netherlands, agencies provide budget forecasts that politicians cannot adjust.

In the United States, there would need to be political will to create a commission or non-partisan agency to conduct budget reviews or to draw up budget legislation. The Base Closure and Realignment Commission, or BRAC, provides a model for using commissions to tie the hands of members of Congress. Members of Congress with military instillations in their districts are loathe to authorize their closures. Through BRAC, the President appoints a non-partisan commission of both private- and public-sector individuals to investigate and recommend the closure of military installations. Its recommendations become final when the President and Congress approve them.

BRAC provides a way for the legislature and executive agencies to delegate highly political decisions to independent bodies. Although BRAC was narrow in scope, there are ways that delegation on budget issues could also provide cover for politicians. If a commission had a limited purpose—to rationalize the tax code, or to eliminate tax expenditures, or to cut spending in specific departments—it could have a significant impact on the budget by taking decision-making authority over intractable political battles away from Congress. Commissions also benefit from stricter deadlines and less transparent procedures than the legislature, resulting in more efficient and decisive policy outcomes.

Avoiding Government Shutdowns

Another set of recommendations about reforming the budget have to do with mitigating the most severe consequences of bargaining failures, which include government shutdowns. As Boris Bershtyn explained, even the threat of a shutdown creates destabilization throughout government agencies, since each agency needs to develop plans for activities in the event of a shutdown. Bargaining failures over budgetary issues such as the debt ceiling are also tantamount to playing chicken with government operations and with global reputation of the United States.

There are many veto points in our political system that increase the probability of bargaining failures over the budget. Most democracies have institutions that try to mitigate the chance of bargaining failure. The costs of bargaining failure can be made very high—for example, when the executive can dissolve the legislature, or when the legislature can remove the executive through a vote of no-confidence. Alternatively, the costs of bargaining failure can be made very low. When there are safeguards in place to ensure continuity of the budget in the event of bargaining failure, there is little chance of shutdown or instability. There are therefore two routes to preventing the worse outcomes of bargaining failures: raising the stakes for political officials to ensure agreement, or lowering the costs of failure so that the consequences are not dire.

There are a few ways to increase the costs of bargaining failure to politicians. Elizabeth Garrett and Gary Cox both cited changing the terms of negotiations by, say, mandating automatic tax increases or suspending essential government services (such as the military and the courts) in the event of a shutdown. Worsening the consequences of bargaining failure would make it more costly to politicians who failed to negotiate.

Politicians could also be subjected to personal consequences, such as forfeiting pay for each day a budget agreement is not reached. After years of late budgets in California, in 2010, voters passed Proposition 25, the Majority Vote for the Legislature to Pass the Budget Act. This initiative dictated that for each day the budget was late, legislators would permanently forfeit their pay. The California State Legislature has passed a budget on time every year since the passage of Prop 25. If members of Congress were held to a similar law, they would be less inclined to delay agreement over budgets.

Conversely, the incentive to negotiate could be strengthened. One way is through bringing back earmarks. Earmarks provided a way for all legislators to gain in the budgetary process, usually through line-item additions of funding to specific projects in appropriations legislation. In 2011, the Republican-led Congress banned earmarks, which are unpopular with the public. As a result, Congressional leaders have fewer tools with which to bargain across party lines. Allowing earmarks would increase the chances for bipartisan agreement on the budget.

Reducing the costs of bargaining failure could also incentivize agreement, or at least ensure that shutdowns do not occur. The primary way to do this would be to change the reversion point: when Congress does not pass a budget, or a continuing resolution, the budget reverts to zero, therefore triggering a shutdown. In other countries, the budget simply reverts to the prior year's budget. Even when decision-making over the budget is divided between branches, Gary Cox calculates that from 1875-2005, the proportion of constitutions with "executive-favoring reversions" doubled. Congress could change the reversion point so that, in the absence of appropriations legislation, the budget would default to appropriations from the prior year. Congress could also agree that if it does not pass appropriations, the President's budget goes into effect. This would encourage Congress to pass and fund its own budget each year.

The Politics of Reforming the Budget

Technical and procedural changes to the budgeting process may not require much public input or approval. However, major overhauls will, and demand for political reforms is usually quite low unless precipitated by crises. Crises provide opportunities to reshape and to reconfigure political, social, and economic landscapes. David Kennedy traced twentieth-century budget legislation to specific political events—the Budgeting Act of 1921 was created after World War I, and the Council of Economic Advisors was created after the Great Depression. Since 2008, the U.S. has experienced a financial crisis and recession. Despite the debt ceiling negotiations of 2013 and the October shutdown, however, neither of the political parties have led efforts to reform budgetary institutions.

Allen Schick observed that unlike other countries, the U.S. dollar, as the premier reserve currency, insulates us against shocks that other countries experience. Whereas economic instability in other countries can trigger capital flight, the dollar allows us to finance our financial mistakes. Further, monetary policy—low interest rates and capital supply—buoys us through difficult economic times. Although the U.S. ranks lower on income equality, health, and welfare than many other prosperous countries, Americans nonetheless feel prosperous. Even robust economies in countries such as Canada and Sweden are sensitive to exogenous shocks in a way the American economy is not.

Can incremental reforms improve the politics of budgeting, or are large-scale reforms necessary? On the one hand, there are many more examples of crisis-led change, such as the cases of Australia and Sweden. Crises generate demands for better policy, and can produce and incentivize coalitions to create political will for reforms. A recent case is that of Japan. Takashi Matsumoto, of the Japanese Ministry of Finance, detailed Japan's macroeconomic crisis from the 1990s onward. GDP growth flattened, social security costs rose, and the government's deficit-financing bonds soon came to constitute over 220% of GDP. After many years in which politicians did little to confront the crisis, in 2012, after 214 hours of debate, the government finally secured a fiscal plan to reign in social security expenses, raise consumption taxes, and work towards halving the deficit by 2015. Similarly, in Italy, Luca Verzichelli showed how budgetary failures and European Monetary Union conditions led the Italian government to strengthen executive control over the budget in the early 2000s. Italy increasingly delegated budgetary authority to finance ministers, and passed a constitutional amendment in 2012 to balance revenues and expenditures.

Crises may create political opportunities to reform budgetary institutions, but given that political leaders in the United States have not capitalized on opportunities to enact sweeping reforms, incremental changes may be a second-best option. Incremental changes have the potential to mitigate the worst effects of bargaining failures. They can address tractable problems in efficient ways, without drawing undue public or media scrutiny.

Perhaps the most realistic approach to reforming budgetary institutions in the United States is to implement technical and procedural fixes that might improve budget implementation from year to year, and to seize opportunities for monumental change when they present themselves. U.S. economic performance over the next few years will be affected by health care costs, entitlement costs, the growing debt, and the lingering effects of the financial problems of the 2000s. Political conflicts over these budget issues will likely get worse, not better. The only potential benefit of economic crises is that they might allow long-term solutions to become politically feasible.

Conclusion: Limitations of Reforming the Budget Process

American political leaders and citizens take many aspects of status quo politics as fixed. They are inclined to see the budgetary process as inherently messy and acrimonious. But examining the United States in comparative perspective reveals that our budgetary process is far less effective than that of other advanced democracies. Indeed, many of the reforms pioneered in the U.S. have been successfully adopted by other countries, while they have failed to produce better policy outcomes at home.

This report has recommended changes at different levels of the budgetary process that could mitigate the effects of polarization. Some reforms could decrease the threat of government shutdowns. Other reforms centralize budgetary authority within the legislative and executive branches, which might facilitate interbranch coordination and efficiency. Finally, budgetary politics could also be delegated to independent commissions to depoliticize as much of the budget process as possible. However, two factors may reduce the impact of reforms to the budgeting process: political culture, and political polarization.

Reforming the politics of the budget is complicated by political culture. Americans are unique in their hostility to many of the budgetary duties and functions of modern government. Sizeable portions of the electorate are opposed to taxes and entitlements; one of the foremost reasons for the shutdown of 2013 was that members of the House of Representatives who were aligned with the Tea Party actually preferred zero spending to the passage of a budget. Even political moderates favor limited government and low taxes.

Reforms to the budgetary process will therefore have a greater chance of success if policy entrepreneurs are able to mobilize the public in favor of better budgetary politics. It is not impossible to persuade the public that shared sacrifice is necessary in times of crisis, but it will require either a significant economic or political shock, or enterprising political rhetoric, to create the desire for reform. Because our political system is sensitive to short-term political gains and losses, it will require creativity to persuade the AARP of the need for entitlement reform, for example, or to reduce tax expenditures to critical constituencies. It might also require experimentation at the municipal and state levels. There have been periods of reform as recently as the 1980s, when Americans accepted a shared sacrifice to improve economic conditions.

The other factor that will influence the effectiveness of proposed reforms is the level of political polarization in contemporary politics. The two parties have become increasingly ideologically divided since the 1970s, and Congress has become far less productive as a result. There are many reasons for political polarization, including skyrocketing campaign financing by special interest groups and the election of extremist candidates to Congress. As a result, experts are skeptic about how much budget reforms will accomplish if they are not accompanied by other reforms, such as limiting campaign finance or establishing new rules in party primaries.

Political culture and partisan polarization exacerbate the cumbersome procedures and ineffective institutions responsible for poor budgetary outcomes in the United States. However, there is growing public discontent with Congress's inability to produce results, particularly over economic matters. Given that political battles over the budget recur each year, devising solutions to the budget process is both urgent and politically feasible. Improving budget outcomes can help to reduce partisan infighting and to generate economic stability. If the United States government is to meet the challenges of the twenty-first century, it must ensure that at the very least, it can guarantee the annual passage of a national budget.