# Is Budget Planning Sequence Fatally Defective?

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[1] For years protests have been lodged over the extent to which revenue and expenditure estimates drive the legislative process. Over the past couple decades, almost every proposal had to be scored as to its impact on the budget, and if it didn't meet scorekeeping rules, it usually could not be enacted or even voted on. Although one could argue that this legislative process gave too much attention to the deficit as the measure of all things, at least in that world one usually started out with a proposal.

[2] Today, however, we have a new game in town. Now we get estimates of the cost of a proposal before the proposal itself has even been designed. And the estimates themselves are made primarily to fit into a soundbite or two, usually about the direction of the budget. While this type of approach might result in decent budget policy, it is almost impossible to believe that good tax or expenditure policy will be a consequence. The sequence used to go from proposal to estimate to soundbite. Policy enacted by reversing that sequence could prove fatally defective.

[3] A case in point is the USA account proposal in President Clinton's latest budget. Although the proposal was not specified in any detail, we were given budgetary estimates of its costs over the next 15 years! This declaration of estimates, in turn, now operates in all sorts of ways to bind administration officials who might be trying to design a proposal that actually adheres to some set of principles or efficiently meets some set of pension policy and tax policy objectives.

[4] How was the cost of the USA proposal decided? To some extent, it was the residual from a sound-bite. The sound-bite was that we were going to allocate the entire surplus in a way that most of it would be "saved" for social security. Don't get me wrong; in my view, both saving the bulk of any surplus and reforming government incentives for private pension saving are good ideas. But then 62 percent of the surplus was already scheduled to be accumulated by social security even before the president's proposals.

[5] That left 38 percent to be allocated, but some of that had already been committed to some modest size defense and domestic policy initiatives. And the administration was committed to trying to allocate some of the surplus to Medicare as well. Meanwhile, additional commitments came about automatically by the way interest payments would rise because of new spending, tax cuts, and other allocations. When bargaining eventually took place on how to spend the residual of the residual, clearly only so much was left for any USA-type proposal.

[6] Precise figures, nonetheless, were required because the administration wanted to set up a new accounting system so that when everything in current law and in their proposals got added together, a new type of "budget surplus" would be measured that would equal exactly zero -- not just on average, but for each and every year for a decade or more. In effect, the "cost" of the administration's total budget package was set before we knew the cost of the pieces that went into the total.

[7] But there remained a little problem. There was no detailed proposal, only the outline of a scheme under which the administration would try to provide a match for private contributions to USA accounts.

[8] Here's where the often forgotten, but vital, revenue estimators come in. The more specific the details provided, the more the revenue estimators can start to show some of the implications. For example, suppose that for policy purposes, Treasury's Office of Tax Policy officials were to suggest that the match should be at a certain minimum level in the first years to induce participation. This information then goes to an estimator who has to make some guess -- and guess, it is -- on participation levels. That information then feeds back into the cost of the proposal.

[9] But this is only the beginning. Once the match is set at some minimum level, presumably it would not be cut back in future years. Accordingly, participation levels are likely to increase as taxpayers get onto some learning curve. In the second year, therefore, private contributions are liable to increase, and so also will the revenue loss.

[10] At this point, compounding comes into play -- and can't be controlled no matter what the desired level of revenue loss. If the proposal induces additional pension saving (something else the estimator has to guess), then the returns on saving are less likely to be subject to individual tax. By the second year, the forgone tax will apply to new deposits and the return on first year deposits. By the third year, the foregone tax will apply to new deposits and the return on second year deposits, and the return on first year deposits and the return on the second year return on first year deposits. And so on.

[11] The estimator now channels that information back into the system through top officials in the Office of Tax Policy, who then pass it on to the Secretary and Deputy Secretary of the Treasury, who then decide when and if they are going to share this information with the Office of Management and Budget and the White House, which are still trying to figure out how this USA account proposal fits in with everything else they are trying to do.

[12] From a policy perspective, however, the problem now is that a variety of effects, such as the compounding of the tax loss, are unlikely to make each year's annual revenue losses fit within the soundbite. So it's continually back to the drawing board to see what else might be done -- with much, if not most, of the work dedicated to trying to refine the policy so that it fits within the estimates, rather than generating the best pension policy for the nation. The Tax Policy estimators and analysts then send back to the policymakers some of the games that might be played -- delays in implementation, matching rates that bounce around over time, matching rates more likely to discourage deposits when the revenue loss isn't wanted, and so on. None of this is likely to be very attractive from a policy standpoint, of course.

[13] By this time the White House types probably are bored with details and may not even want to know all the implications. They've got their bigger issues to fight, like how to keep Congress from spending too much of the surplus. They, along with the Treasury Secretary and Deputy Secretary, will come out with some general statements that, well, they are open to all sorts of negotiation with Congress, and so one shouldn't pay too much attention to the estimates in the first place. Indeed, as they acquire more information they become more reluctant to present too many details of any USA account proposal. Not only will this raise all sorts of issues within the pension community about choice of design, but it will almost inevitably involve revenue losses different from the ones they just presented in the budget. Even if the revenue losses managed to be approximately what had originally been proposed, the maneuvering to get the proposal close to the estimates will probably reveal some unattractive design features.

[14] To be fair, the Treasury and White House officials may indeed be trying to work for a better policy design, but the way the game is played in Washington, they can never publicly reveal mistakes, miscalculations, inadequate preparation, or simply better alternatives to what the president has announced, at least this soon after the announcement. Those on the outside looking to score points often look to such revelations as political ammunition, rather than a means of working out a better policy.

[15] Certainly at the highest political level it might not matter all that much. Only future negotiation is likely to determine whether this type of USA account proposal even takes off, and if it does, what refinements have to be made. Congress, however, is even less capable of coming up with a detailed design than is the administration because of the latter's access to a much larger trained civil service with diverse skills. Meanwhile, top administration and congressional officials are devoting attention to how to use certain parameters -- the size of the surplus, the size of the non-social security surplus, and so on -- as overall constraints on congressional action this year. While there will be much disagreement between the political parties, both sides realize that spending or cutting taxes cannot get totally out of control, so both know there must be some budget rule, explicit or implicit, to guide action.

[16] Politically, then, the focus will turn to these larger budget issues, and the press will concentrate its attention mainly on those fights. If reform of private pensions passes by the wayside because no well-designed option served as a base for negotiation, no one will really get blamed.

[17] This will not be the first or last time tax and expenditure policies are proposed without first engaging in the difficult work of designing according to a set of principles and goals. But there are long-term consequences to developing a government whose policies are attuned less and less to whether any particular purpose is met efficiently or fairly. From soundbite to estimate to proposal: from a policy perspective, it's a fatally defective sequence.

## Other Publications by the Authors

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