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by
Howell E. Jackson*

Abstract

Public discussion of federal fiscal policy typically focuses on several familiar metrics of performance, including the total deficit, the level of public debt and percentage of federal spending committed to mandatory spending and net interest payments. While useful, these measures are based on accounting conventions developed years ago, and do not capture many of the ways in which the federal government now commits public resources, including obligated budget authority, guarantees associated with various government insurance programs, retirement benefits for federal workers and military personnel, and — most substantially — federal social insurance programs such as Social Security and Medicare. Collectively these programs and activities represent substantial and largely overlooked current commitments of future federal resources. After reviewing current measures of fiscal performance, the article presents several alternative ways to quantify federal financial performance over the first half of this decade utilizing more comprehensive measures of mounting federal financial obligations. So, for example, while the commonly reported total deficit of the federal government in FY2005 was \$318 billion, a more comprehensive measure of fiscal results over the course of the same year would have shown a deterioration in the country's net financial position in excess of \$3.3 trillion — that is, an order of magnitude larger. To promote more informed debate and encourage more responsible public leadership, the more comprehensive measures of fiscal performance described in this article should be adopted as the primary metrics for reporting the financial performance of the federal government.

* James S. Reid, Jr., Professor of Law, Harvard Law School. This essay benefitted from the work of students in my Federal Budget Policy Seminar at Harvard Law School and conversations with Alan Auerbach, Jim Cooper, Richard Fallon, Beth Garrett, Daryl Levinson, Deborah Lucas, Dan Meltzer, Daniel Shaviro, and Matthew Stephenson, as well as comments and suggestions from participants at a February 2006 Conference on Fiscal Challenges: An Interdisciplinary Approach to Budget Policy held at USC Law School and at March 2006 session of the NYU Tax Colloquium in March 2006. I am also grateful for generous financial support from the John M. Olin Center for Law, Economics and Business at Harvard Law School. An earlier version of this paper formed the basis of my inaugural lecture for the James S. Reid, Jr., Chair at Harvard Law School.

Counting the Ways: The Structure of Federal Spending

by

Howell E. Jackson

In the realm of budget policy, numbers are important. The size of the deficit, the level of public debt, and a handful of commonly cited ratios, all have great political salience in budgeting decisions. When the Congressional Budget Office (CBO) issues a report or the President unveils his annual budget proposal, these actions are immediately evaluated by reference to key budgetary measures. These measures are based on particular accounting principles, most of which were developed decades ago with minor adjustments over time.¹ Accounting principles are not, however, immutable. Other principles apply in other jurisdictions and indeed different principles are applied in assembling the Financial Reports of the U.S. Government, to which neither the general public nor budget experts pay much attention.² The question I explore in this essay is whether we should move towards different methods of accounting – methods more similar to the rules of accrual accounting applied in other sectors of the economy – to inform public debate over federal budget policy.

The structure of my analysis is straightforward. First, I review the key measures of fiscal performance that currently frame federal budget policy, examining both the content of these measures themselves and the principal reasons why these measures are thought to be relevant to

¹ The foundation of modern budgetary aggregates is the Report of the President's Commission on Budget Concepts (Oct. 1967). To a large degree, this essay call for a reconsideration of the principles articulated in that report.

² The figures discussed in this article are drawn largely from the Fiscal Year 2005 Financial Report of the United States Government (Dec. 2005) (available at <http://www.gao.gov/financial/fy2005financialreport.html>). The report was reproduced in a printed version with an foreword by Representative Jim Cooper (D-Tn.) in the summer of 2006. See Financial Report of the United States (2006) (Nelson Current, Publisher). For a useful comparison of the Financial Report of the United States Government and traditional budgetary measures, see Congressional Budget Office, Comparing Budget and Accounting Measures of the Federal Government's Fiscal Condition (Dec. 2006) [hereinafter "CBO Comparison"].

public understanding of fiscal matters. I then identify several important aspects of our federal government's fiscal affairs that are not captured in these standard measures. Most of the areas I discuss are currently reported in the Financial Reports of the U.S. Government, though some appear only as supplementary materials and not in the principal statements of financial condition. In many cases, the information omitted from our traditional budgetary aggregates is material, and these omissions compromise the integrity of public debate over fiscal decisions. I conclude with some preliminary thoughts about the implications of my critique of traditional budgetary measures and then suggest a general framework that should inform the rules of accounting for federal budget policy. Throughout the chapter, I report budget aggregates through fiscal 2005, the most recent year for which complete financial information (including Social Security and Medicare) is available.

I. Public Debate Over Federal Budget Policy: Measures and Meaning

What are the key measures of fiscal performance that policy experts distill from the mountains of budgeting minutiae to help the general public understand how the federal government is managing its financial affairs? And why do policy experts center on these particular measures of fiscal performance as focal points for public debate?

A. Three Key Measures of Fiscal Performance

The most common measure of our national government's fiscal performance is the federal budget's total deficit or surplus. Typically, this measure is calculated on an annual basis, as it was when the CBO reported the FY2005 total deficit at \$318 billion and projected, albeit in a somewhat stylized manner, a FY2006 deficit of \$337 billion.³ (Table One presents summary information from the CBO's January 2006 Budget and Economic Outlook.) These two annual deficit estimates – the recent fiscal year's and the next – were widely reported in the popular press the day after CBO

³ See Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2007-2016* (Jan. 2006) [hereinafter "CBO January 2006"].

released its report,⁴ and are the most frequently cited measures of federal budget results. Occasionally, public attention is also directed to a multi-year aggregation of these annual measures of fiscal performance, as was the case back in January 2001 when the CBO projected \$5.0 trillion of cumulative surpluses for FY2001 through FY2010.⁵ By way of comparison, the January 2006 CBO report projected aggregate deficits over this same ten-year horizon of \$2.5 trillion, roughly \$1.1 trillion of actual accumulated deficits for the past five fiscal years, and another \$1.3 trillion

Table One
Selected Elements of Historical and Projected Federal Budgets: 2001 Through 2010
(billions of dollars)

	Actual					Projected					
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	
Total Revenues	\$1,991	\$1,853	\$1,783	\$1,880	\$2,154	\$2,312	\$2,461	\$2,598	\$2,743	\$2,883	
Outlays											
Discretionary Spending	\$649	\$734	\$825	\$895	\$968	\$999	\$1,000	\$1,022	\$1,040	\$1,060	
Mandatory Spending	\$1,008	\$1,106	\$1,182	\$1,238	\$1,320	\$1,432	\$1,488	\$1,572	\$1,667	\$1,755	
Net Interest	\$206	\$171	\$153	\$160	\$184	\$217	\$244	\$263	\$277	\$289	
Total Outlays	\$1,863	\$2,011	\$2,160	\$2,293	\$2,472	\$2,648	\$2,732	\$2,857	\$2,984	\$3,105	
Total Deficit	\$128	-\$158	-\$378	-\$413	-\$318	-\$337	-\$270	-\$259	-\$241	-\$222	
Public Debt Held By Public (Year End)	\$3,320	\$3,540	\$3,913	\$4,296	\$4,592	\$4,925	\$5,204	\$5,477	\$5,732	\$5,967	
Total Deficit as Percent of GDP	1.3%	-1.5%	-3.5%	-3.6%	-2.6%	-2.6%	-2.0%	-1.8%	-1.6%	-1.4%	
Public Debt at Year End as Percent of GDP	33.0%	34.1%	36.1%	37.2%	37.4%	37.6%	37.8%	37.8%	37.6%	37.2%	

Source: CBO, The Budget and Economic Outlook: Fiscal Years 2007 to 2016 (Jan. 2006).

projected for the next five. If one were to look for a single statistic to explain the recent resurgence of public and political interest in federal budget policy, it would be this precipitous \$7.5 trillion swing from a \$5 trillion ten-year projected surplus in 2001 to a \$2.5 trillion ten-year deficit for the same projection period five years later.

⁴ See, e.g., Jackie Calmes, *CBO See Wider Deficit this Year and in 2016 if Tax Cuts Don't End*, WALL ST. J., Jan. 27, 2006, at A4 (reporting \$318 billion deficit for FY05 and projected deficit of \$360 billion in FY06, which includes the \$336 billion deficit reported above plus estimated additional costs for supplemental spending on military activities and flood relief).

⁵ See Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2002-2011* (Jan. 2001).

A closely related measure of fiscal balance is the amount of federal debt held by the public. Several years ago, public debt levels gained political salience because of concerns that mounting federal surpluses might force the federal government to redeem substantially all federal debt, thereby eliminating an important financial instrument and perhaps forcing the federal government to invest its excess cash reserves in private capital markets.⁶ More recently, concerns have focused on increases in public debt outstanding. Mounting annual deficits mean that the amount of public debt outstanding is on the rise again, a potentially deleterious side-effect of fiscal imbalance.

Although, as explained below, there is not a perfect match between total budget deficits and annual increases in public debt outstanding, the relationship is quite strong. So, for example, the CBO's January 2006 projections indicated that the federal public debt would increase from \$4.6 trillion at year-end FY2005 to nearly \$6.0 trillion at year-end FY2010, that increase of \$1.4 trillion is comparable for the five-year annual deficits projected during that period for the federal government's total budget. In other words, measures of public debt outstanding can be thought of as a cumulative measure of the federal government's total annual deficits and surpluses. For that reason, public debt and changes in public debt are convenient summary measures of fiscal performance, often used in public debate over federal budget policy.

A somewhat more refined measure of federal budget policy deals with the composition of federal spending. As illustrated in Table One, budget experts often distinguish between various categories of federal spending, most typically discretionary spending, mandatory spending, and net interest payments. These divisions sometimes confuse members of the general public, as they do not track more familiar programmatic lines (such as defense spending or public works projects) but they relate to the manner in which Congress authorizes federal outlays and hence have a high degree of salience to budget experts. Typically, what experts stress in discussing current budgetary trends is the declining share of discretionary spending in the federal budget (going from 39.15 percent of total outlays in FY2005 to a projected 34.14 percent in FY2010) as compared with the rising share

⁶ Howell E. Jackson, *Could We Invest the Surplus?*, TAX NOTES, Feb. 26, 2001, at 1245.

of mandatory spending (going from a 53.41 percent share in FY2005 to a projected 56.52 percent in FY2010). While this long-term trend was interrupted in the first half of this decade as costs associated with the defense department spending and other Bush Administration priorities expanded discretionary spending, the rise in relative importance of mandatory spending is projected to

Table Two
Composition of Total Federal Outlays Historical and Projected: 2001 Through 2010
(Percentage of Total Outlays)

	Actual					Projected					
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	
Discretionary Spending Share	34.85%	36.51%	38.21%	39.04%	39.15%	37.73%	36.60%	35.77%	34.85%	34.14%	
Mandatory Spending Share	54.08%	54.99%	54.70%	53.97%	53.41%	54.08%	54.47%	55.02%	55.86%	56.52%	
Net Interest Share	11.07%	8.50%	7.09%	6.99%	7.44%	8.19%	8.93%	9.21%	9.28%	9.31%	

Source: CBO, The Budget and Economic Outlook: Fiscal Years 2007 to 2016 (Jan. 2006).

dominate long-term budget projections, as was emphasized in another recent CBO report.⁷ Also occasionally mentioned in discussions of the changing composition of federal spending is the growing significance of net interest payments, projected in the CBO's January 2006 report to rise from 7.44 percent of total outlays in FY2005 to 9.31 percent in FY2010.

So, to recap, the public is implicitly being asked to keep track of three basic issues in thinking about the federal budget. The first two are aggregate measures of fiscal balance: the annual total deficit or surplus – measured annually or over some multi-year time horizon – and the amount of public debt outstanding. The third measure concerns the distribution of total federal outlays, principally the division between discretionary and mandatory spending but also sometimes including net interest payments.

B. Why Do We Care About These Measures of Fiscal Performance?

Suppose, by way of illustration, some well-intentioned member of the general public were confronted with the three measures of performance of fiscal performance mentioned above –

⁷ See Congressional Budget Office, The Long-Term Budget Outlook (Dec. 2005).

essentially the information presented in Tables One and Two – and then asked why policy makers care so much about these particular numbers. This perfectly reasonable question could be answered in a number of different ways, but I think most experts in the field would stress the measures' values in assessing the past performance of the federal government in fiscal affairs, in predicting a likely result of future performance over the next few years, and finally in identifying the relative ease with which Congress and the President will be able to make fiscal adjustments at least with respect to spending decisions in the near term. In the following subsections, I will expand upon each of these considerations and also say a few words about several complicated and unresolved normative issues that the considerations raise.

1. Retrospective Assessment of Past Fiscal Performance

There are a host of reasons why we might care about the relationship between government revenues and outlays as reflected in both total budgetary aggregates (that is total deficits and surpluses) and changes in public debt levels. Within the budgetary context, the most prominent concern is that the costs of excessive deficits and unbridled growth in public debt will have to be borne by taxpayers and other national stakeholders in future years. Experts use deficits and changes in the level of public debt as scorecards for determining how fiscally responsible our political leadership has been on this dimension. A separate justification for focusing on these measures is the impact of deficits and public debt on private capital formation: if the government is borrowing excessively to finance increases in public debt, private borrowers may be crowded out of the market. Again, measures of recent deficits and changes in debt levels are one useful measure of the federal government's appetite for capital.

Of course, simply noting that deficits and debt levels are useful for identifying excessive burdens on future taxpayers and excessive crowding out of private capital markets does not provide particularly useful guidance as to the normative question of how large deficits or debt levels should be. And within budget policy circles, there is a good deal of confusion and disagreement about this normative issue. Proponents of balanced budget amendments and the targets written into the original Gramm-Rudman-Hollings Act implicitly aimed for a deficit target of zero. While one

cannot deny the elegance of a balanced budget goal, there are many reasons to suspect that it is a poor policy guidepost in many contexts. In an inflationary environment, a balanced budget implies declining real level debt. It is not entirely clear why the government should always want to reduce the real level of public debt. One might just as easily postulate a constant real level of debt as the a reasonable policy goal, in which case the optimal deficit would be a function of the size of the debt relative to government spending and the rate of inflation. Or one might target a constant level of public debt as a percentage of the GDP, in which case one would also have to factor real GDP growth into one's calculation of optimal deficits.⁸

A further complication in setting normative criteria for budgetary aggregates or public debt is the manner in which federal resources are deployed and the incidence of their benefits. High deficits and rising federal debt during the Second World War are often cited to illustrate this point. Because the benefits of these war-time expenditures accrued to future generations in the form of a (relatively) peaceful world, the ordinary rules of fiscal balance were thought not to apply in the first half of the 1940's. While this illustration is compelling, what is less clear is what other kinds of federal expenditures have a similar impact on optimal debt and deficit levels or when the merits of governmental expenditures might counsel for more crowding out of private investment than is usually desirable. Many kinds of government spending might be characterized as investments to benefit future generations – for example, infrastructure projects or expenditures on public education – and it is not clear which are legitimate justifications for deficit financing. Finally, macroeconomic considerations, in the Keynesian sense, also suggest that overall condition of the national economy may have an influence on optimal deficit and debt levels. In brief, deficits and debt levels are important, but the experts are currently hard-pressed to tell us in what precise way they are important or exactly how to tell when they are out of synch with fully theorized criteria.

In the absence of a fully developed theory of deficits and debt, we proceed in a world of

⁸ For a more formal treatment of these considerations, see Michael J. Boskin, "Economic Perspectives on Federal Deficits and Debt," in *FISCAL CHALLENGES: AN INTERDISCIPLINARY APPROACH TO BUDGET POLICY* (Elizabeth Garrett, Elizabeth Graddy, & Howell E. Jackson, eds.) (forthcoming Cambridge University Press 2007).

common wisdom and rules of thumb. Back in the first Reagan Administration, OMB Director David Stockman could worry about \$200 billion dollar a year deficits as far as the eye could see, and there was general consensus among experts that deficits at this level (roughly six percent of GDP or \$738 billion if based on the 2005 GDP) was excessive. Today, some policy experts assert that the \$1.1 trillion in cumulative deficits during FY2001 through FY2005 also exceeded reasonable upper bounds, but others defend the deficits as not substantially higher than the average annual deficit that the country has run since the mid-1960's (2.3 percent of GDP).⁹ A further defense of recent deficits stresses the fact that recent expenditures for national security and homeland security justify some degree of fiscal imbalance, much as World War II expenditures justified fiscal imbalance six decades ago.

With respect to public debt, there is also a tendency to survey historical trends and reverse engineer normative guidelines. So, for example, OMB often presents charts illustrating that public debt levels have ranged between a low of 23.9 percent of the GDP in 1974 to a high of 49.4 percent in 1993 and emphasizing that levels at year-end 2005 were 37.4 percent of GDP, very close to the mid-point of the range over the past 45 years.¹⁰ While again there is not a fully formed theory on the matter, there seems to be some rough consensus among policy experts that public debt levels between thirty to forty percent of GDP constitute a tolerable burden for future generations and presumably an acceptable degree of crowding out for the capital markets. Not only is this the range within which the United States government has operated for more than a half a century without untoward economic consequences, it is consistent with the fiscal guidelines that the European Union has established for member states in the Euro zone.¹¹

⁹ See CBO January 2006, *supra* note 3, at xiii (“At 2.6 percent of gross domestic product (GDP), this year’s [FY2006’s] deficit would be slightly larger than the 2.3 percent average recorded since 1965.”).

¹⁰ See, e.g., Office of Management and Budget, *The Nation’s Fiscal Outlook* (Feb. 2006) (available at <http://www.whitehouse.gov/omb/budget/fy2007/outlook.html>).

¹¹ See Jürgen von Hagen, “European Experiences with Fiscal Rules and Institutions,” in *FISCAL CHALLENGES*, *supra* note 8. Although, in my experience, analysts typically do not extrapolate optimal deficit guidelines from these bands of acceptable public debt, one can easily derive implicit deficit levels

To conclude, there is general agreement among budget experts that deficits and changes in public debt levels are important measures of past fiscal performance. While there is no similar consensus as to what levels those measures maintain, the common practice is to evaluate those measures as a percentage of current GDP and to benchmark recent performance against historical ranges.

2. The Value of Prospective Measures: Trends and Benchmarks

Unlike past budgetary aggregates, which are largely objective reflections of past events, prospective measures depend upon a series of assumptions about what might happen over the next year or more. One could make these projections in a variety of ways, and there is actually a fair amount of controversy among budgetary experts about how these projections should be done.¹² The CBO estimates used in this paper were based on statutory standards, which require the use of current laws and, on the spending side, project current year spending into the future.¹³ In brief, the CBO “baseline” projection rules work as follows: Discretionary spending is projected to increase with inflation, and mandatory spending is projected to increase with a more liberal formula that takes into account changes in the projected number of beneficiaries. Revenues are projected to track current laws, and where certain provisions are scheduled to expire – like the Bush Administration tax cuts of recent years – those sunsets are assumed to go into effect, regardless of the likelihood of intervening changes in law.

While one can quibble about the specific assumptions underlying these baseline projections,

with a formula that include current public debt levels, targeted public debt levels, and expected rates of nominal increase in the GDP. This approach assumes that, once public debt reaches the targeted level – say, thirty percent of GDP – a country can incur deficits at a level that will sustain the public debt as a constant percentage of GDP. As long as there is real economic growth, the real levels of public debt will be increasing.

¹² See Alan J. Auerbach, et al. *New Estimates of the Budget Outlook New Estimates of the Budget Outlook: Plus Ça Change, Plus C'est la Même Chose*, TAX NOTES, April 17, 2006, at 349; Jared Shirck & Francis Shen, *The Role of Estimation in Budget Procedures: Baselines* (May 4, 2005) (available at <http://lawweb.usc.edu/cs1p/conferences/fiscal%20challenges/documents/4-Baselines.pdf>).

¹³ See 12 U.S.C.A. § 907 (West 2006) (definition of baseline).

budget policy experts focus on them because these projections convey the consequences of our current fiscal commitments as extrapolated into the future – akin to the vision the Ghost of Christmas Future conveyed to Ebenezer Scrooge. And, just as we care how well government officials have managed fiscal affairs in the immediate past, we are concerned about how our fiscal fate will unfold in the immediate future. If we persist in current policies, how closely will revenue and spending align in future years? To what degree will future spending exceed revenues, thereby deferring additional costs to future years and crowding out private investment through the issuance of public debt? As before, the underlying normative questions of how large projected deficits and public debt level can grow before they become problematic remain obscure, but the notion that the public should be attuned to these projections is universally accepted. And, in the extremes, the appropriate course of action may be clear. In the early 1980's, deficits of \$200 billion as far as the eye could see prompted a variety of congressional reforms, including the creation of much of our current federal budgetary process. Projections of ten year surpluses in excess of \$5.0 trillion in 2001 prompted a political consensus for fiscal adjustments in the opposite direction. But in both instances, actions were precipitated by projections of future trends in fiscal balance or imbalance.

A related, but distinct role of future projections is to set a benchmark against which policy changes can be scored. These baseline projections are supposed to represent fiscal results if the federal government leaves its fiscal policies on automatic pilot. The fiscal implications of future governmental actions – that is, deviations from the status quo – are thus evaluated against projections, both in the terms of the direction of a potential change and the magnitude of its effect. In times of budgetary stringency, political leaders are often assessed on how well they perform in terms of reducing projected deficits. So, for example, congressional leaders might take credit for reconciliation bills that cut medicaid spending as compared with levels included in CBO baseline projections made at the start of the budgeting process.¹⁴ Or, taking a multi-year perspective, critics

¹⁴ See, e.g., Deborah Solomon, *Wrestling with Medicaid Cuts*, WALL ST. J., Feb. 16, 2006, at A4. See also Allen Schick, *THE FEDERAL BUDGET PROCESS 58-20* (2000) (explaining how current service baselines allows Congress to impose annual cuts but still permit annual increases in program expenditures).

of the Bush Administration might buttress charges of fiscal mismanagement by comparing the Administration's fiscal performance over the past five years against the fiscal surpluses projected at the end of President Clinton's presidency. Budgetary projections can also be used to set prospective reform agendas. For example, several years ago, President Bush set his own fiscal target by proposing to half the FY09 deficit from the projected FY2004 deficit made in February 2004.¹⁵ Congressional budget resolutions commonly set similar targets for annual improvements against baseline projections, and congressional budget procedures often set longer-term schedules for spending reductions against baseline levels. Thus, projected budgetary aggregates and public deficit levels become public benchmarks against which politicians score fiscal points or incur fiscal penalties. While ultimate fiscal results matter in the long run, results as compared with expectations have a high degree of political salience in the short term.

The dual functions of budgetary projections explain why the conventions underlying baseline methodologies have become so controversial. On the one hand, to the extent that these projections present the likely fiscal consequences of continuing current policies, incumbent politicians have an incentive to make these projections look as favorable as possible. So, for example, the Bush Administration's budgetary policies will appear on a more balanced path if, as is the case with the CBO projections used in this paper, projections fail to extrapolate future spending for supplemental appropriations in FY2005 or assume the expiration of major tax cuts after FY10. To project fiscal responsibility, politicians have an incentive to low ball future deficits. However, because budgetary projections also serve as a benchmark to assess future legislative reforms, there are countervailing incentives that work in the opposite direction. High projected spending levels make it easier for politicians to find politically advantageous spending cuts, and projections that assume the extension of expiring tax cuts make it easier to get those cuts extended.¹⁶ The relative merits of different

¹⁵ See, e.g., Office of Management and Budget, *supra* note 10.

¹⁶ So, for example, critics of the recent Tax Reform Panel have complained that the panel's recommendations were biased in favor of lower taxes by working off of a baseline that included, among other things, extensions of President Bush's tax cuts See, e.g., Leonard E. Burman & William G. Gale, *A Preliminary Evaluation of the Tax Reform Panel's Report*, TAX NOTES, Dec. 5, 2005, at 1349.

methodologies for budgetary baselines is beyond the scope of this paper. But the fact is that these methodologies have become controversial, and this controversy supports my claim that these projections have assumed a high degree of political salience.

3. The Capacity to Adjust Spending Decisions and the Risk of Fiscal Ossification

Although budgetary aggregates – whether deficits or surpluses – usually capture the headlines, a persistent subplot in many stories about the federal budget is the changing composition of federal expenditures, most significantly the relentless rise in annual expenditures on entitlement programs such as Social Security, Medicare, and Medicaid. At one level, concern over growth in these items is puzzling as one might have thought that it was a good thing for a society to allocate a greater share of public resources dedicated to the elderly, the infirmed and the impoverished. But, in budgetary circles, the reason these trend lines are identified as problematic is that they are growing faster than the overall economy and also often faster than the growth in federal revenues. Moreover, the manner in which Congress approves spending for these mandatory programs is quite different than traditional appropriations for other governmental activities. Whereas the traditional process requires both authorizing substantive legislation and annual appropriations, mandatory spending is often (though not always) locked in through permanent appropriations. Rather than requiring annual enactments to continue their funding, mandatory programs often persist in the absence of legislative intervention.¹⁷ So, while the baseline projections of spending over multi-year horizons represent a best guess as to trends in current fiscal commitments, some of those commitments are more difficult to adjust than others.

So, referring back to Table Two, consider projections for FY2010. CBO's January 2006 projections indicated that 9.3 percent of projected spending will take the form of net interest

¹⁷ Thus, mandatory programs can over time take on a distinctly counter-majoritarian flavor. Their persistence need not reflect majority support, but rather the blocking power of minority interests. Take, for example, the Social Security program, which was initially launched and most recently amended at times in which both houses of Congress had Democratic majorities (the New Deal and 1983). Even if subsequent majorities of both Houses and the President favored Social Security reform, there was no guarantee that reform would occur as minority interests, particularly in the Senate, have considerable power to obstruct reform proposals.

payments, probably the most binding of all federal outlays inasmuch as reductions in net interest payments imply a default of public debt. Mandatory spending, the vast majority of which is based on social insurance programs, is projected to constitute another 56.5 percent of projected outlays in FY2010. That leaves only 34.1 percent of outlays for discretionary programs, including the defense department and almost all general government functions. By highlighting the changing composition of federal outlays, federal budget experts are calling attention to the fact that nearly two thirds of the federal budget will be on some form of automatic pilot by the end of this decade. Since the net interest portion of this growth can only be addressed through reductions in prior year deficits, the strong implication is that we need to do something to reduce entitlement spending and that our commitments to these programs have become too large for us to afford.

Once again, this framing of our budget choices raises some nice normative questions. Is there a good reason for us to distinguish so sharply in the legislative procedures – really the default rules – for spending on mandatory programs as opposed to discretionary items? Is there something about the constituencies for mandatory programs that warrants procedural safeguards against spending cuts? Do the beneficiaries of these programs have such strong reliance interests that changes in program terms should only be made under extraordinary circumstances and outside of annual appropriation reviews? Or should we perhaps be concerned of the anti-majoritarian implications of putting spending programs on automatic pilot and take actions to resist the special interests that have inserted these spending rules into the federal budget process? Looking over a list of mandatory programs – which include a wide range of social services, retirement and disability benefits for federal workers and military personnel – is it possible to imagine a coherent theory that justifies the budgetary preference for this group of expenditures as opposed to the many other ways in which the federal government allocates its financial resources?

These are large and difficult questions, which I have no intention (or hope) of answering here. My point is simply that an important element of our public debate over budgetary projections is the increasing extent to which net interest payments and mandatory programs threaten to ossify our fiscal future. In the immediate term, this poses the question of whether we should make some

substantial downward adjustments in these commitments. Over the longer term, we need to consider whether we shouldn't reduce the number of programs that are permitted to operate under fiscal automatic pilot procedures, thereby reducing what may have become excessively sticky fiscal commitments and resulting reliance interests.

II. A Critique of Existing Measures of Fiscal Performance

Having identified both the principal measures we currently employ to evaluate federal fiscal policy and the functions these measures are supposed to serve, I now consider whether there are important elements of our fiscal life that these measures fail to capture or substantially misrepresent. To a large degree, I proceed here by argument through laundry list. Ordered loosely by the magnitude of their significance, I describe below four aspects of fiscal policy that are not fully reflected in the budgetary measures we typically employ.¹⁸ Each omitted area bears directly on at least one of the purported functions of our current budgetary measures. Accordingly, their omission potentially compromises the integrity of public debate over federal fiscal policy. For the most part, these omitted areas can be quantified, and, to the extent practical, I include estimates of their significance and growth over the first half of this decade. I conclude with a presentation of the

¹⁸ I might well have added as a fifth aspect, the magnitude of future appropriations specified in authorizing statutes. Authority to appropriate is not the same as an appropriation, and executive branches and agencies cannot obligate funds based solely on authorizing statutes. Authorizing statutes do, however, have some bearing on future spending levels. At a minimum, they set benchmarks for "full funding," about which constituents can complain if the President recommends or Congress appropriates at levels less than those authorized, as for example has happened in public debate over the No-Child-Left-Behind Act. Accordingly, authorizing bills might be understood to set soft baselines for certain programs that may be a good deal higher than those included in most CBO and OMB projections. I do not include authorization levels in my analysis here because the degree of commitment they represent has become relatively limited over time and because a substantial share of discretionary spending is now made without authorizing statutes, notwithstanding the continued existence of House and Senate Rules that formally impose procedural limitations on such appropriations. See Congressional Budget Office *Unauthorized Appropriations and Expiring Authorizations* (Jan. 2006). See also Mark Champoux & Dan Sullivan, "Authorizations and Appropriations: A Distinction Without Difference?" (May 10, 2006) (available at http://www.law.harvard.edu/faculty/hjackson/auth_appro_15.pdf). According, it seems implausible that any reform in budgetary measures would be based on estimates derived from authorized level of appropriations as opposed to actual spending.

aggregate effects of these omitted areas on fiscal performance over the past half decade.

While the selection of areas presented in this analysis may seem a touch random, there is a common theme. Consider for a moment a lobbyist in Washington whose task is to gain access to federal resources for a client. Assume further that the budgetary measures discussed in the preceding section are binding in the sense that they are more difficult for politicians to satisfy the lobbyist's needs with the immediate outlays of cash, which would increase the reported deficit and levels of public debt. How might a lobbyist advance his or her client's interests under these conditions? What follows, in essence, is a list of suggestions. All arguably can advance the interests of the lobbyist's client and none is fully picked up by the budgetary measures upon which we traditionally rely. But gains for the lobbyist's client also constitute burdens for the federal government and future generations. So budgetary measures that fail to reflect obligations arising out of these strategies may understate the growth of fiscal burdens – both historically] and prospectively – and may also disguise the extent of fiscal ossification. The exclusion of these strategies from budgetary aggregates also means that they do not factor into the baseline for budgetary reform.

A. Trends in Unexpended Budgetary Authority

It is often remarked that the federal budgetary process is based on obligation authority.¹⁹ Under pain of criminal sanction, executive officers and agency officials are not permitted to obligate federal resources (much less pay out cash) in the absence of explicit budget authority.²⁰ So an important component of all spending bills is the inclusion of budget authority, which may come in the form of annual budget authority or multi-year budget authority. None of the budget measures

¹⁹ See Government Accountability Office, *The Methods for Tracking Funds in the Federal Government*, in *A Glossary of Terms Used in the Federal Budget Process* App. III (Sept. 2005) (GAO-05-734 SP) (distinguishing obligational accounting from proprietary accounting). See also Cheryl D. Block, *Congress and Accounting Scandals: Is the Pot Call the Kettle Black?*, 82 NEB. L. REV. 365, 404 (2003).

²⁰ See Antideficiency Act, 31 U.S.C.A. § 1341 (2006). This criminal sanction is distinct from but serves to safeguard the requirements of U.S. CONST., art. I, § 9, cl. 7, that funds not be withdrawn from the Treasury without appropriation by Congress.

discussed so far in this paper concern budget authority. Rather they depend (for the most part) on “outlays,” that is the amount of cash payments made from the U.S. Treasury during the course of the fiscal year. For programs that depend on annual budget authority, outlays are apt to approximate budget authority. But for programs with multi-year budget authority, this equivalence will not hold true.²¹ And, herein, lies potential mischief.

Without having any impact on current year deficits, a lobbyist can lock in future spending for clients by obtaining multi-year budget authority. And, if one refers to Table Three, one can see that outstanding budget authority at year-end has been increasing, both in terms of unobligated budget authority and in terms of obligated but unliquidated authority. Not only has this outstanding authority been increasing in absolute terms, but it has become larger as a percentage of current outlays – growing from 55.5 percent of outlays at year-end FY2001 to 59.4 percent of year outlays at year-end FY2005. So, it would appear, lobbyists have been relatively more successful in obtaining long-term budgetary authority over the past half decade, quite plausibly as a result of increases in defense spending where long-term budget authority – for example, for weapons systems – is more common. Some of this increase may also be due to growth in the Medicaid program, where annual budget authority typically covers state funding into one quarter of the next fiscal year.

²¹ For illuminating discussion as to how differences in outlays and budget authority affected the Gramm-Rudman-Hoillings Act sequestration rules, see Kate Stith, *Rewriting the Fiscal Constitution: The Case of Gramm-Rudman-Hollings*, 76 CAL. L. REV. 593, 640-41 (1988).

The growth in outstanding budget authority has implications for the budgetary aggregates reviewed earlier in this essay. When one considers projections with respect to discretionary

Table Three
Budget Authority Outstanding: 2001 Through 2005
(billions of dollars; Year-end)

	2001	2002	2003	2004	2005
Unobligated Budget Authority	\$341	\$343	\$383	\$407	\$541
<u>Obligated but Unliquidated Budget Authority</u>	<u>\$693</u>	<u>\$741</u>	<u>\$790</u>	<u>\$864</u>	<u>\$928</u>
Total Budget Authority Outstanding	\$1,034	\$1,084	\$1,173	\$1,271	\$1,469
Total Budget Authority Outstanding as % of Total Outlays	55.5%	53.9%	54.3%	55.4%	59.4%
Total Budget Authority Outstanding as% of GDP	10.3%	10.4%	10.8%	11.0%	11.9%

Source: Financial Reports of the U.S. Government: FY2001, FY2002, FY2003, FY2004, FY 2005.

spending in FY07 and beyond, appropriation committees do not have quite as much budgetary flexibility as the numbers superficially suggest.²² Compared to the past, an increasing percentage of outlays have already been authorized. While Congress can rescind unobligated budgetary authority and even has some capacity to back out of obligated authority (potentially subject to contractual damage awards), the presence of large and growing outstanding budgetary authority balances at fiscal year ends indicates that our fiscal hands are even more bound than traditional presentations suggest. Moreover, this ossification extends to discretionary spending, not just mandatory spending.

B. Loans And Guarantees

²² Certain recissions, however, may give rise to liability for damages authorized under the Tucker Act. See Stacy Anderson & Blake Roberts, Capacity to Commit in the Absence of Legislation: Takings, Winstar, FTCA, & the Court of Claims (May 4, 2005) (available at <http://lawweb.usc.edu/cs1p/conferences/fiscal%20challenges/documents/12-CapacitytoCommitt.pdf>). See also Robert Porter, Contract Claims Against the Federal Government: Sovereign Immunity and Contractual Remedies (May 2, 2006) (available at http://www.law.harvard.edu/faculty/hjackson/ContractClaims_22.pdf).

Another important area in which past congressional actions has committed the government to future expenditures is in the area of loans and guarantees. Here, however, the commitments are partially reflected in the budgetary aggregates. As a result of the Federal Credit Reform Act of 1990, the federal budget recognizes the subsidy cost of direct loans and loan guarantees in the year in which the loan is made or the guarantee extended.²³ Table Four, drawn from the Financial Reports of the U.S. Government, presents an estimate of the annual level of these subsidies for the past five years, with the most recent year – FY2005 – showing a subsidy cost of \$14 billion. The Federal Credit Reform Act represents an unusual bit of accrual accounting appended onto federal budgeting aggregates, which are otherwise limited to comparing revenues and outlays. This accounting convention means that when the federal government makes a direct loan or extends a

Table Four					
Subsidy Cost of Federal Loan & Guarantee Programs					
(billions of dollars)					
	2001	2002	2003	2004	2005
Annual Loan and Guarantee Subsidy Costs	\$1	\$5	\$12	\$7	\$14
Loan Guarantee Liabilities (Year End)	\$28	\$28	\$35	\$43	\$48
Loan Guarantee Liabilities as Percent of GDP	0.3%	0.3%	0.3%	0.4%	0.4%

Source: Financial Reports of the U.S. Government: FY2001, FY2002, FY2003, FY2004, FY 2005.

loan guarantee, the projected “subsidy” cost of that transaction must be reflected in the federal budget that year. So, the \$14 billion of subsidy costs for FY2005 reported in Table Four factored into the year’s \$318 billion total deficit. This aspect of these financial arrangements is reflected in

²³ For an introduction to the Federal Credit Reform Act, See Neill Perry & Puja Seams, Accrual Accounting for Federal Credit Programs: The Federal Credit Reform Act of 1990 (Apr. 20, 2005) (<http://lawweb.usc.edu/cs/p/conferences/fiscal%20challenges/documents/6-AccrualAccounting.pdf>). While the Federal Credit Reform Act forces the budget process to recognize some of the costs associated with lending and guarantee programs, academic observers are increasingly concerned that the Act’s recognition rules understate the cost of the programs by ignoring market risks. For an introduction to this issues, see Deborah Lucas & Marvin Phaup, The Cost of Risk to the Government and Its Implications for Federal Budgeting (Feb. 2007) (unpublished manuscript on file with author).

total budget deficits and surpluses.

But the liabilities associated with federal guarantees are not fully incorporated into all of our budgetary aggregates. Although the cost of subsidies is reflected in annual deficit totals, the liabilities that these deficits generate are not considered part of the public debt of the United States. At least as far as commonly cited cumulative budgetary aggregates are concerned, these loan liabilities are effectively off-balance sheet liabilities. Thus, the \$48 billion of loan guarantees outstanding at year-end FY2005 (see Table Four) do not figure into the public debt numbers reported in Table One and prominently factored into public debates about public debt burdens as a percentage of GDP.²⁴

To be sure, the magnitude of our loan guarantee liabilities is quite small in comparison to our public debt levels (\$48 billion versus \$4.5 trillion at year-end FY2005) and so one might well dismiss this omission as non-material. But the general point that the federal government might be incurring financial liabilities that are functionally similar to explicit public debt but not included in public debates over fiscal policies is important. And, as we will see shortly, the magnitude of other omissions is often highly material. Moreover, in most other contexts, the recognition of the liability does not factor into annual deficit totals at the time the commitment is made. Rather, the liabilities factor into budgetary aggregates only when they are liquidated, well after there is any realistic opportunity to reduce their magnitude and without ever having been subject to the kind of public scrutiny and consent associated with traditional annual appropriations.

C. Other Accrual Measures Not Reflected in Current Budgetary Aggregates

Many different kinds of federal financial activities share the same basic structure as loan guarantees: the commitment of financial obligations now – often associated with the receipt of a premium-like-payment or service – with the expectation, often contractual, that the government will

²⁴ It may also be the case that annual implicit interest costs of subsidized direct loans and direct guarantees are not reported in budgetary aggregates. These subsidies are recognized in the federal budget on a discounted basis, which means that they grow in size until recognized. This implicit interest should, in theory, be recognized on an annual basis, but may not be under current practices.

liquidate the obligation at some point in the future. In this section, I will review two important illustrations – the operations of the Pension Benefit Guarantee Corporation (PBGC) and various benefits for federal workers and military personnel. I use these examples both because of their financial importance and because estimates of their magnitude can be derived from the Financial Statements of the U.S. Government and other publicly available reports. I conclude this section with a review of the aggregate financial performance of the U.S. Government, as reported in its financial reports, in comparison to the budgetary aggregates that commonly inform public discussion of the subject.

1. Pension Benefit Guarantee Corporation

As can be gleaned from any number of recent press accounts, the financial condition of the PBGC has been deteriorating over the past few years. Table Five extracts selected statistics from the Corporation's annual reports, which show that PBGC has incurred net losses (on an accrual basis) for four out of the last five years. Its net position – basically its net worth on a book value basis – has shifted from a positive \$8 billion to a negative \$23 billion in the last five years. The liabilities of the PBGC, like those of other federal insurance programs, are reflected in the Financial

Reports of the U.S. Government, which has increased its estimate of the corporation's recognized liabilities from \$14 billion to \$70 billion since FY2001. Indeed, if one digs into the footnotes of these reports, one finds there are even larger levels of possible losses (from companies such as GM that may attempt to terminate underfunded pension plans in the next few years and pass on substantial additional losses to the PBGC). Most experts agree that the PBGC will incur substantial additional losses over the next few years, with long term losses likely to push the corporation's net position in the range of negative \$50 billion to \$100 billion over the next five years.

Table Five

Annual Losses and Insurance Program Liabilities of PBGC (billions of dollars)

	2001	2002	2003	2004	2005
<i>PBGC Annual Report:</i>					
Net Income (Loss) for Year	-\$2	-\$11	-\$8	-\$12	\$0
Net Position at Year End	\$8	-\$3	-\$11	-\$24	-\$23
<i>Financial Reports of the United States Government:</i>					
PBGC Insurance Program Liabilities (Year End)	\$14	\$29	\$45	\$61	\$70
PBGC Liabilities as Percentage of GDP	0.1%	0.3%	0.4%	0.5%	0.6%

Source: Financial Reports of the U.S. Government: FY2001, FY2002, FY2003, FY2004, FY 2005.
Annual Reports of PBGC: FY2001, FY2002, FY2003, FY2004, FY 2005

In contrast to the grim economic reality of the PBGC's financial condition, federal budgetary aggregates factor in only the PBGC's current revenues and outlays. In an Orwellian reversal, this difference means that the financial operations of PBGC actually have made a positive contribution to the federal budget (reducing deficits) over the past five years, because cash inflows from PBGC premiums and other sources have actually exceeded its outlays. Moreover, in the President's FY2007 budget proposal (as well as recently enacted reconciliation legislation), increased PBGC premiums are projected to generate more budgetary savings over the next few years, even though it is highly

likely that the corporation's financial condition will deteriorate further in that period.

Return now to the traditional budgetary aggregates discussed earlier. Missing from the aggregate deficits reported for the past four years is the decline in financial prospects of the PBGC. Indeed, rather than showing five year losses of about \$31 billion suggested from the corporation's own accrual based financial statements, the federal budget scored PBGC activities as a net fiscal contribution during these years. Absent also from the public debt measure is any recognition of the financial obligations of the PBGC, estimated in the Financial Reports of the U.S. Government as a \$70 billion liability at year-end FY2005 or as a \$23 million negative net position reported in the PBGC's annual report for the same period. While there are undoubtedly differences between the PBGC's liabilities and explicit federal debt – among other things, the PBGC is not formally backed by the full faith and credit of the United States – one wonders whether our public debt measure is well designed to summarize the country's accumulated financial obligations at the end of each fiscal year if it omits entirely these PBGC obligations.²⁵

²⁵ Analogous to the PBGC but slightly more removed from direct federal control are the many government sponsored enterprises, such as Fannie Mae and Freddie Mac. Though owned by the government, these firms do arguably expose the federal government to possible liability, and hence their financial performance arguably bears on the government's overall financial position. For further discussion of GSEs, see Block, *supra* note 19, at 435. See also Richard S. Carnell, *Handling the Failure of a Government Sponsored Enterprise*, 80 WASH. L. REV. 565 (2005).

2. Military Personnel, Civil Government Employee and Veteran Benefits

An even more substantial set of federal obligations relate to benefits owed to military employees, veterans, and civilian employees.²⁶ Some of these costs are reflected in the federal budget as outlays, but a substantial amount of accruals (including implicit interest on past accruals) is not included in federal budgetary aggregates. Table Six summarizes the level of benefit accruals that have *not* been included in traditional budgetary aggregates for the past five years. These amounts are on the order of hundreds of billions of dollars a years, with the aggregate levels of benefits payable in the range of trillions of dollars. (Note these liabilities are gross figures and not offset for corresponding balances which are reported separately as assets on the Financial Statements of the U.S. Government.) Neither the existence of these figures nor their annual increase is reflected in our traditional budgetary aggregates discussed earlier.

	2001	2002	2003	2004	2005
Accrued Costs from Military Employee Benefits	\$407	\$32	\$101	\$143	\$170
Accrued Costs from Veterans Benefits	\$139	\$157	\$106	-\$30	\$198
Accrued Costs from Civilian Employee Benefits	\$39	\$39	\$80	\$69	\$62
Total Accrued Costs of Benefits Not Reflected	\$585	\$229	\$287	\$182	\$430
Total Accrued Costs as Percentage of GDP	5.8%	2.2%	2.6%	1.6%	3.5%
Total Benefits Payable at Year End	\$3,361	\$3,589	\$3,880	\$4,062	\$4,492
Benefits Payable as Percentage of GDP	33.4%	34.6%	35.8%	35.2%	36.5%

Source: Financial Reports of the U.S. Government: FY2001, FY2002, FY2003, FY2004, FY 2005.

3. Net Position of the United States

With time and effort, one could work through every element of the Financial Statements of

²⁶ For additional discussion of this topic, see Hiroyuki Kohyama & Allison Quick, *Accrual Accounting in Federal Budgeting: Retirement Benefits for Government Workers* (May 1, 2006) (available at http://www.law.harvard.edu/faculty/hjackson/RetirementBenefits_25.pdf).

the U.S. Government and consider the extent to which the component elements are omitted from traditional budgetary aggregates. In highlighting the financial results of the PBGC and federal benefit programs, I have chosen areas which strike me as particularly problematic omissions from federal budgetary aggregates. Each area is functionally similar to the loan guarantees. Each year the government receives a benefit (analogous to a loan guarantee premium and the gratitude of a constituent who received credit support) in exchange for an obligation to expend resources in the future. In the case of PBGC, actual premiums are taken in today in exchange for a financial commitment to support failed private pension programs in the future. With benefit programs, the government receives today the services with employees and military personnel who accept reduced current wages and in exchange commits to benefit payments in the future. Total deficit measures that omit these obligations while recognizing the benefits of PBGC premium receipts and lower wages misrepresent the burdens imposed on future taxpayers from current governmental activities. Similarly, public debt measures that omit the implicit liabilities of these programs understate the cumulative burdens of past governmental operations.

I leave to another day the question of whether other aspects of the accrual accounting system

reflected in the Financial Statements of the United States should also be incorporated into our budgetary aggregates.²⁷ For readers who are interested in the areas of difference, I would commend Figure One, in which I have reproduced a quite informative reconciliation statement, which

Table Seven					
Key Results from Financial Reports of the United States					
(billions of dollars)					
	2001	2002	2003	2004	2005
Statement of Conditions:					
Net Operating Costs	-\$515	-\$365	-\$665	-\$616	-\$760
Net Operating Costs as % of GDP	-5.1%	-3.5%	-6.1%	-5.3%	-6.2%
Balance Sheet:					
Total Assets	\$926	\$997	\$1,394	\$1,397	\$1,456
Federal Debt Securities Held by Public	\$3,359	\$3,573	\$3,945	\$4,329	\$4,624
Other Liabilities	\$4,026	\$4,244	\$4,554	\$4,778	\$5,291
Total Liabilities	\$7,385	\$7,817	\$8,499	\$9,107	\$9,915
Net Position	-\$6,459	-\$6,820	-\$7,105	-\$7,710	-\$8,459
Net Position as Percentage of GDP	-64.2%	-65.6%	-65.5%	-66.7%	-68.8%

Source: Financial Reports of the U.S. Government: FY2001, FY2002, FY2003, FY2004, FY 2005.

illustrates the factors generated for the United States net operating losses of \$615.6 billion and \$760.0 billion on an accrual basis in FY2004 and FY2005 but “only” \$412.3 billion and \$318.5 billion in budgetary deficits for the same two years. For current purposes, I would point readers to Table Seven, which summarizes the key statistics from the accrual-based Financial Reports of the United States for the last five years. Emphasized here are net operating losses (analogous to but much larger than our total budget deficits) and the net position of the United States (similarly in spirit to, but broader and larger than our public debt). The quite substantial differences between these two reporting approaches raise, in my view, some fundamental question about the accuracy and completeness of our current budgetary measures.

²⁷ For additional background on the Financial Reports of the United States, and the Financial Accounting Statement Advisory Board (FASAB) that promulgated the rules under which these reports are prepared, see David Burd & Takeshi Fujitama, FASAB & the Financial Statements of the United States: Comparing Budgetary Aggregates to Financial Statements (May 3, 2005) (available at <http://lawweb.usc.edu/csfp/conferences/fiscal%20challenges/documents/13-FASAB.pdf>).

Figure One

(In billions of dollars)	2005	2004
Net operating cost	(760.0)	(615.6)
Components of Net Operating Cost Not Part of the Budget Deficit:		
Increase in Liability for Military Employee Benefits (Note 11):		
Increase in military pension liabilities	57.7	98.7
Increase in military health liabilities	108.6	42.3
Increase in other military benefits	3.3	2.4
Increase in liability for military employee benefits	169.6	143.4
Increase/(Decrease) in Liability for Veterans Compensation (Note 11):		
Increase/(decrease) in liabilities for veterans	150.1	(39.7)
Increase in liabilities for survivors	47.2	9.6
Increase in liabilities for burial benefits	0.5	0.1
Increase/(decrease) in liability for veteran's compensation	197.8	(30.0)
Increase in Liabilities for Civilian Employee Benefits (Note 11):		
Increase in civilian pension liabilities	43.6	39.8
Increase in civilian health liabilities	24.6	21.7
(Decrease)/increase in other civilian benefits	(5.9)	7.2
Increase in liabilities for civilian employee benefits	62.3	68.7
Increase/(Decrease) in Environmental Liabilities (Note 12):		
Increase/(decrease) in Energy's environmental liabilities	8.1	(1.7)
Increase in all others' environmental liabilities	2.5	1.0
Increase/(decrease) in environmental liabilities	10.6	(0.7)
Depreciation expense	79.7	89.9
Property, plant, and equipment disposals and revaluations	47.8	0.2
Increase in benefits due and payable	14.1	2.9
Increase in insurance programs	31.0	37.0
Increase/(decrease) in other liabilities	15.1	(4.7)
Seigniorage and sale of gold	(0.8)	(0.7)
Increase/(decrease) in accounts payable	7.8	(2.1)
(Increase)/decrease in accounts and taxes receivable	(9.7)	0.3
Components of the Budget Deficit Not Part of Net Operating Cost:		
Capitalized Fixed Assets:		
Department of Defense	(110.2)	(83.2)
Civilian agencies	(36.4)	(28.9)
Total capitalized fixed assets	(146.6)	(112.1)
Increase in inventory	(10.5)	(8.8)
Increase in securities and investments	(18.2)	-
Increase in other assets	(5.0)	(11.7)
Principal repayments of precredit reform loans	9.7	8.5
Net amount of all other differences	(13.2)	23.2
Unified budget deficit	(318.5)	(412.3)

The accompanying notes are an integral part of these financial statements.

D. Social Insurance Commitments

A final area of federal financial activity to consider are social insurance programs, such as Social Security and Medicare, our most important forms of mandatory spending. As I and others have explored elsewhere,²⁸ these programs have functional similarities to other forms of federal guarantees and employee benefits. In exchange for payroll taxes paid during their working lives, participating workers become eligible for future pensions, retiree health, and various other ancillary benefits. So current revenue streams, principally from payroll taxes, are associated with the accrual of future statutory liabilities. Our current budgetary principles recognize current revenues but ignore the accrual of liabilities for future payments. Instead, current revenues are offset with current outlays to liquidate liabilities that the federal government incurred in the past. Whereas both of these social insurance programs would report substantial and increasing losses if their financial statements were prepared in a manner that recognized the current accumulation of future obligations and the implicit interest cost of previously incurred obligations, the total budgetary aggregates we commonly employ (the \$318 billion deficit of FY2005) actually count Social Security as a positive contribution in the amount of the program's \$173 billion cash flow surplus that year. Our common measures of public debt entirely omit statutory obligations under these social insurance programs nor, indeed, do they even recognize the government securities issued to trust funds in support of social insurance commitments to future beneficiaries.

In prior writings, I have developed methodologies for converting the annual accrual of liabilities for social insurance programs into measures analogous to more common budgetary aggregates.²⁹ In Table Eight, below, I report a summary of this presentation format for both Social

²⁸ See Howell E. Jackson, *Accounting for Social Security and Its Reform*, 41 HARV. J. LEGIS 59 (Winter 2004). See also Jagadeesh Gokhale & Kent Smetters, *FISCAL AND GENERATIONAL IMBALANCES* (2003).

²⁹ At least partially in response to prior academic writing on the subject, the Federal Accounting Standards Advisory Board recently published a "preliminary views" document in which a majority of the Board recommended that the federal government start recognizing the government's social insurance obligations on an accrual accounting basis. See Federal Accounting Standards Advisory Board, *Preliminary Views – Accounting for Social Insurance*, Revised (Oct. 23, 2006) (available at http://www.fasab.gov/pdf/files/socialinsurance_pv.pdf). The approach to accrual accounting proposed by

Security and Medicare for the most recent five years for which data is available. The measure featured here is the “closed group liability” for each program.³⁰ This measure reflects the present value of benefits due to all current participants less the present value of all future tax contributions that current participants are expected to pay into the program. The measure reflects the financial burden or liability being passed on to future generations.³¹

the majority of the FASAB board differs in certain technical respects from the approach utilized in this article, but the underlying premises are similar. For a brief discussion of the political hurdles that the FASAB proposal has still to surmount, see Howell E. Jackson, *Big Liability: Social Security, Medicare, and Accounting*, THE NEW REPUBLIC ONLINE (July 12, 2006) (avail. at <http://www.tnr.com/docprint.mhtml?i=w060710&s=jackson071206>).

³⁰ Gokhale and Smetters refer to this measure as the program’s generational imbalance. See Gokhale & Smetters, *supra* note 28, at 10-15.

³¹ In this presentation, following FASAB guidelines, no offset is included for trust fund balances. The measures of closed group liability included in Social Security Administration documents typically do include such offsets, because their focus is the trust funds as separate entities. As this paper – and FASAB requirements more generally – present a consolidated government perspective, trust fund offsets are inappropriate.

Table Eight
Closed Group Obligations of Social Security and Medicare Programs
 (billions of dollars; Calendar Years)

	2001	2002	2003	2004	2005
Social Security Program:					
Increase in Closed Group Liability for Participants 62+	\$108	\$249	\$219	\$409	\$402
<u>Increase in Closed Group Liability for Participants 15-61</u>	<u>\$567</u>	<u>\$277</u>	<u>\$591</u>	<u>\$622</u>	<u>\$991</u>
Total Increase for Year	\$675	\$526	\$810	\$1,031	\$1,393
Closed Group Liability at Year End	\$11,216	\$11,742	\$12,552	\$13,583	\$14,976
Total Increase for Year as Percentage of GDP	6.7%	5.1%	7.5%	8.9%	11.3%
Closed Group Liability as Percentage of GDP	111.5%	113.0%	115.8%	117.6%	121.8%
Medicare Program:					
Increase in Closed Group Liability for Participants 62+	\$21	\$290	\$968	\$211	\$217
<u>Increase in Closed Group Liability for Participants 15-61</u>	<u>\$392</u>	<u>\$1,821</u>	<u>\$8,640</u>	<u>\$1,513</u>	<u>\$2,484</u>
Increase in Closed Group Liability	\$413	\$2,111	\$9,608	\$1,724	\$2,701
<u>Offset for Projected Increase (Decrease) in General Revenues</u>	<u>(\$131)</u>	<u>\$1,203</u>	<u>\$7,383</u>	<u>\$1,152</u>	<u>\$1,149</u>
Increase in Adjusted Closed Group Liability	\$544	\$908	\$2,225	\$572	\$1,552
Adjusted Closed Group Liability at Year End	\$6,298	\$7,206	\$9,431	\$10,003	\$11,555
Adjusted Increase for Year as Percentage of GDP	4.1%	20.3%	88.6%	14.9%	22.0%
Adjusted Closed Group Liability as Percentage of GDP	62.6%	69.4%	87.0%	86.6%	94.0%
Source: Financial Reports of the U.S. Government: FY 2005 and 2006 Trustees Reports for Social Security and Medicare					

The magnitude of the figures reported in Table Eight is striking. The closed group liability of the Social Security system alone is more than three times the public debt, and has been growing by more than \$500 billion a year since the beginning of the decade, with most of the growth coming from increases in commitments to working-age Americans, those between 15 and 61. Annual increases of “legacy debt” of Social Security have therefore been a good deal larger than annual increases in our public debt. Yet, the accrual of liabilities in the Social Security system is wholly absent from our traditional federal budgetary aggregates.

The annual growth in unfunded liabilities of Medicare over the past five years has also been

substantial. It is, however, more difficult to estimate the growth in Medicare liabilities because the program is only partially funded through dedicated revenues and thus some amount of future general revenues should probably be allocated to the program in order to produce a fair estimate of the fiscal gap associated with this program. Following a methodology proposed by Auerbach, Gale, & Orszag, I have adjusted in Figure Eight the annual increase in reported closed group obligations of Medicare to reflect projected increases in the amount of general revenues available for the program.³² Table Eight indicates that the degree of Medicare under-funding has increased substantially since the beginning of the decade. The massive spike in liabilities in FY2003 from the enactment of the Medicare Part D Prescription Drug Benefit is a major factor here, but so too is the implicit interest charges associated with pre-existing Medicare liabilities. Again, our principal budgetary aggregates – total deficits and public debt – omit the fiscal impact of mounting Medicare liabilities.

E. An Alternative Perspective on Budgetary Aggregates and Trends

As a final exercise, I present in Table Nine an alternative presentation of the fiscal policies of the United States over the past five years.³³ The table starts with our traditional budgetary aggregates – total reported deficits or surpluses as well as explicit public debt levels – and then adds net losses and changes in net position from the Financial Reports of the United States as well as changes in the closed group liabilities of Social Security and changes in adjusted closed group obligations of Medicare. Not factored into this analysis is the impact of increased levels of outstanding budgetary authority, because I lack an obvious means of quantifying the financial impact of these increases.

³² To make these projections, I assumed that Medicare would continue to receive the same ratio of general revenues to dedicated payroll tax contributions for Part B and D in the future as it did in the most current fiscal year. This methodology generates a substantially smaller adjusted closed group liability for Medicare than does the projection method favored by Gokhale and Smetters, who assume no general revenue contributions for future Medicare benefits.

³³ A prior and less complete attempt at a similar consolidation appeared in Howell E. Jackson, *Mind the Gap*, TAX NOTES, Dec. 20, 2004, at 4.

While one could quibble about the manner in which I have converted these obligations into annual increases in fiscal burden and accumulated measures of financial burdens, the basic lesson of the table is hard to resist. In a variety of ways, financial claims against the United States have

Table Nine
Alternative Presentations of Overall Fiscal Policies
 (billions of dollars; Calendar Years for Social Security and Medicare)

	2001	2002	2003	2004	2005
Annual Impact of Fiscal Policies					
Total Budget Deficit or (Surplus) as Reported	-\$128	\$158	\$378	\$413	\$318
Change in Other Net U.S. Operating Cost	\$643	\$207	\$287	\$203	\$442
Change in Social Security Closed Group Liability	\$675	\$526	\$810	\$1,031	\$1,393
<u>Change in Medicare Adjusted Closed Group Liability</u>	<u>\$544</u>	<u>\$908</u>	<u>\$2,225</u>	<u>\$572</u>	<u>\$1,552</u>
Total Annual Impact	\$1,734	\$1,799	\$3,700	\$2,218	\$3,705
Total Annual Impact as % of GDP	17.2%	17.3%	34.1%	19.2%	30.1%
Accumulated Burdens from Past Fiscal Policies					
Public Debt Outstanding	\$3,320	\$3,540	\$3,913	\$4,296	\$4,592
Net U.S. Position Minus Public Debt Outstanding	\$3,139	\$3,280	\$3,191	\$3,414	\$3,867
Closed Group Liability of Social Security	\$11,216	\$11,742	\$12,552	\$13,583	\$14,976
<u>Adjusted Closed Group Liability of Medicare</u>	<u>\$6,298</u>	<u>\$7,206</u>	<u>\$9,431</u>	<u>\$10,003</u>	<u>\$11,555</u>
Total Accumulated Burden	\$23,973	\$25,768	\$29,088	\$31,295	\$34,989
Total Accumulated Burden as % of GDP	238.3%	248.0%	268.3%	270.9%	284.6%

grown much faster in the past five years than would be suggested by our traditional budgetary aggregates. Compared to the GDP, the annual increase in these claims has exceeded seventeen percent in all years and reached 34.1 percent in 2003,³⁴ the year in which Congress enacted a new prescription drug benefit. Similarly, the level of accumulated financial burden – the analog to public debt – has jumped by more than ten trillion dollars between 2001 and 2005, rising from 238.3 percent of GDP to 284.6 percent.

³⁴ The annual data in this table represents a blend of calendar year information of Social Security and Medicare and fiscal year information for all other data.

Not only does this alternative presentation call into question the validity of our traditional measures of annual deficits and public debt, the presentation also suggests that the ossification in our spending latitude is even greater than currently understood. Once one recognizes the extent of our overall financial obligations, the implicit interest payments on these obligations also become clear. The obligations presented in Table Nine are largely based on present value estimates of future payments. Thus, with each passing year, these obligations increase, reflecting an implicit interest charge on these obligations. While traditional budgetary projections of the sort reflected in Table Two show annual net interest payments for the last years of this decade running in the range of \$200 to \$300 billion, the total interest costs for the federal government (explicit and implicit) must be on the order of ten times higher – that is, over a trillion dollars a year. This hidden interest charge is the critical fact of our country’s fiscal condition, but it is wholly absent from our public debate over fiscal matters.

Finally, this alternative presentation raises questions as to whether our traditional budgetary aggregates present a true measure of the impact of federal fiscal policies on capital markets. The off-balance sheet liabilities that I have included in my alternative presentation do not, for the most part, draw funds directly out of private capital markets, and in that sense do not crowd out other private borrowers, but these liabilities may have a similar indirect effect. Many of these liabilities represent assets for private individuals – for example Social Security retirement payments, Medicare commitments, benefits for government employees, and even solvency protection for private pension plans. The existence and growth of these claims likely reduce private savings of other kinds, thereby reducing the supply of capital to some degree. The extent of this effect is contested,³⁵ but given the magnitude of the government’s off-balance sheet liabilities today – and their continuing growth – the impact of the effect is most likely substantial. Budgetary aggregates that focus solely on public debt or current deficit totals thus understate the impact of federal fiscal policy on private capital raising.

³⁵ See Jackson, *supra* note 28, at 97-98 .

III. Implications, Extensions and Further Lines of Research

In the main, the foregoing analysis has been limited to an extended critique of a current approach to budgetary aggregates as inadequate to fulfill the purposes for which they are designed: providing meaningful summary information about past financial performance and future trends in the nation's fiscal matters. My argument is that there are a host of ways in which financial claims are perfected against the United States – that is, the fiscal burden imposed. Many important ones are wholly or largely absent from traditional measures of fiscal performance, as evidenced by standard CBO and OMB presentations. These omissions call into question the usefulness of traditional measures, either as report cards or predictions of our fiscal future. Moreover, to the extent that politicians and the general public are relying on macro-economic rules of thumb to guide their scrutiny of fiscal matters – public debt in the range of 40 to 60 percent of GDP is acceptable or deficits in the range of 2 to 3 percent of the GDP are fine – one wonders whether the guidelines are appropriately specified for the modern context.

The analysis raises many interesting and difficult questions about the political economy of the federal budget process. If, as my analysis assumes, current budgetary aggregates impose some degree of discipline on traditional spending through current outlays but imposes less stringent constraints on the accrual of other kinds of obligations, then a number of implications follow. First,

we would expect to see claimants who could satisfy their needs through less constrained forms of spending to be more successful than those who must work through traditional annual outlays. Arguably, the spike in Medicare obligations in 2003 – largely undetected through traditional budgetary aggregates –

would be consistent with this hypothesis. We might further predict that, at the margin, politicians would attempt to meet constituent demands through providing support with spending that is less well monitored and regulated than traditional appropriations. So, rather than providing current job training to workers in declining manufacturing sectors, Congress might countenance increased guarantees of unfunded

pension obligations through the PBGC. Or rather than increase the current wages of federal employees, the legislature might enrich their benefits, the cost of which does not need to be recognized in future years. In many contexts, there will be plausible off-balance sheet substitutes

Box One

Is Accounting Irrelevant?

Whenever one challenges the inadequacy of accounting measures, as I do throughout this essay, a possible objection is that accounting treatments do not matter, as long as the underlying facts are publicly available. As all of the information presented in this essay is drawn from government documents, one might therefore argue that the public (and the economic profession) is already aware of this information. So any change in budgetary aggregates would have not impact on either political outcomes or economic guidance. Perhaps, but I am skeptical. There is some empirical evidence that accounting treatments to affect political outcomes, at least in the context of off budget treatment of social insurance programs. Sita Nataraj & John B. Shoven, *Has the Unified Budget Undermined the Government Trust Funds?*, NBER Working Paper W10953 (Dec. 2004). Moreover, in the context of state budgeting, it appears that recent reforms requiring the current recognition of accrued benefit costs is having an impact on the willingness of state legislature to continuing offering these benefits at the same level in the past. See Stanley C. Wisniewski, *Potential State Government Practices Impact of the New GASB Accounting Standard for Retiree Health Benefits*, 25 PUBLIC BUDGETING & FIN. 104 (Mar. 2005). Still, one must acknowledge that this is a point of uncertainty. If accounting measures do not matter, than the force of my argument is much diminished.

for direct spending.³⁶ This latter point suggests that a further cost of different levels of budgetary discipline is that there may be efficiency costs in forcing claimants (like workers in declining industries) to accept a less preferred form of federal support (e.g, PBGC guarantees) because of budgetary rules. Finally, underlying these positive claims, is a complex normative issue: is there some reason – possible flaws in our political culture and needs of particular constituencies – that some claimants should be subject to different degrees of budgetary discipline than others? If so, do these normative considerations justify the current contours of budgetary aggregates or some other structure?³⁷

My analysis also poses some challenging questions on the boundaries of law and accounting, particularly if one is motivated to expand upon our traditional budgetary aggregates and propose a new and more comprehensive system of budgetary accounting. To what extent should we expect the law to tell us which commitments are “legally binding” and therefore appropriate for inclusion in budgetary aggregates. At first blush, this may seem a plausible and bright line for establishing financial obligations. I am, however, skeptical, that the law can fully solve this problem. It is

³⁶ A major reason why the Federal Credit Reform Act of 1990 was enacted was to prevent Congress from substituting what appears to be costless guarantees for what appeared to be excessively expensive loans. So my hypothesis regarding spending substitution has some historical basis. See also CBO Comparison, *supra* note 2, at 8 (noting advantages of accrual accounting over traditional budget measures in managing federal programs). Other predictions included in the text are speculative, but might be subject to empirical validation or disproof.

³⁷ The federal process is replete with other illustrations of privileged spending and constrained competition for budgetary resources. As discussed earlier, important procedural differences advantage most forms of mandatory spending as compared with discretionary spending. When Congress sets separate multi-year discretionary caps for defense programs and non-defense programs, constituents funded in one area do not have to compete with those funded in other areas. Section 302(b) allocations to appropriations subcommittees have a similar effect. See David Burd & Brad Shron, *Analysis & Critique of Specialized Rules: Discretionary Caps, Spending Targets, and Committee Allocations* (May 4, 2005) (available at <http://lawweb.usc.edu/cs1p/conferences/fiscal%20challenges/documents/1-SpecializedRules.pdf>). The PAYGO rules themselves forced a form of competition in which tax cuts and mandatory spending were forced to compete against each other in order to survive procedural points of orders. See Ellen Bradford & Matthew Scogin, *PAYGO Rules and Sequestration Procedures* (May 4, 2005) (available at <http://lawweb.usc.edu/cs1p/conferences/fiscal%20challenges/documents/2-PAYGO.pdf>). All of these channeling mechanisms raise difficult normative questions, worthy of further study.

certainly the case that the current structure of budgetary aggregates does not turn on the presence or absence of legal duties, commonly understood. Many of the liabilities reported on the balance sheet of the Financial Reports of the U.S. Government but not captured in traditional budgetary aggregates are legal obligations of governmental entities – for example, loan guarantees or employee and military benefits. Even the PBGC program represents a statutory commitment, albeit one from an entity that is not explicitly supported by the full faith and credit of the federal government. Strictly speaking, even the obligations of the Social Security and Medicare programs are legal obligations defined by federal statute, albeit ones for which there are not currently in place full appropriations once the Social Security trust funds are depleted in several decades. So current budgetary rules do not come close to picking up all federal obligations that represent legal duties.

Another legalistic way of approaching financial obligations is to distinguish between those obligations which Congress could rescind by legislative Act from other obligations. This distinction is usually made with respect to Social Security where the statute specifies and the Supreme Court has confirmed that Congress is free to change benefit formulas at any time. Some argue that at least with respect to social insurance programs, the fact that Congress could amend benefits provides a complete justification for not recognizing the liabilities that current statutory obligations represent. From a law professor's perspective, this distinction is not as sharp as it might initially appear to others. Under the doctrine of sovereign immunity, the U.S. government is constitutionally empowered to avoid any legal obligations, even, in theory, explicit public debt but also guarantees, contracts, and most other financial obligations. Private parties can proceed against the federal government on these and other claims only because Congress has chosen to waive sovereign immunity in a variety of contexts. But the government could withdraw that waiver.³⁸ Of course the

³⁸ A possible limitation to this proposition exists when government action constitutes an unconstitutional taking of property or a violation of the Contract Clause. Arguably, such an action gives rise to legal liability for the federal government, but there remains uncertainty over whether government might avoid payment on even these claims by failing to appropriate funds. For an introduction to some of the difficult issues these questions raise, see John Harrison, "New Property, Entrenchment, and the Fiscal Constitution," in *FISCAL CHALLENGES: AN INTERDISCIPLINARY APPROACH TO BUDGET POLICY*, *supra* note 8.

government doesn't – at least, the U.S. Government hasn't for the last two hundred years – but that is because the political and economic costs of waiver are thought to be prohibitive. But, similar reasons explain why Congress does not lightly exercise its power to alter Social Security benefits. Social Security, like public debt and like all other governmental obligations, are binding not for purely legal reasons, but for political ones. In all cases, the government has the “legal” option of adjusting statutory entitlements or exerting sovereign immunity, but it just doesn't choose to do so.³⁹

So if legal rules will not provide the way, how should we determine which financial commitments should be incorporated into our basic financial aggregates? An alternative approach is to look to the accounting discipline and seek to identify those obligations (1) that arise out of past transactions and (2) that give rise to probable future economic sacrifice – in other words, a functional, probabilistic approach that considers both the likelihood of future expenditures and the context in which those obligations arose. Working quickly through some of the areas canvassed in this paper, this approach would point in the following directions:

Outstanding Budgetary Authority at Fiscal Year-End: Though outstanding budgetary authority does give rise to future economic sacrifice, in most cases past transactions will not yet have occurred, even with obligated resources so perhaps this authority should not be recognized unless some substantial amount of service has been provided or goods delivered. However, prominent disclosure – akin to footnotes in corporate financial statements – would be appropriate for these latent liabilities and it might make sense to specify in budgetary projections what share of projected discretionary spending is already “locked in” by advanced appropriations.

Loan Guarantees: These obligations satisfy the accounting definition of liabilities, entailing both past transactions and future economic sacrifice, and should be included in measures of cumulative financial burdens as well as annual changes in those burdens.

³⁹ Among public law scholars, there is apparently some debate over the meaning of sovereign immunity: whether the doctrine authorizes the government to escape legal liability or whether the doctrine merely permits the government to evade enforcement of private legal rights. For my purposes, these disagreements are metaphysical niceties, which do not bear on my functional claim that the government has wide latitude to avoid financial obligations when the political will exists.

PBGC Financial Obligations: Like loan guarantees, past transactions have occurred in the receipt of premium payments and the extension of insurance coverage. The probable future economic sacrifice dimension is more difficult because of the absence of full faith and credit support for the PBGC. Some evaluation of probability is called for in such contexts, and one could look both to past precedent – like the savings and loan bail out – and current expectations to draw a conclusion here. The FASAB requirements underlying the Financial Statements of the U.S. Government call for consolidation of corporations such as PBGC, and that strikes me as the most sensible conclusion in this context, though conceivably one could imagine other similarly structured entities with different budgetary accounting treatment. Privately owned GSEs, such as Fannie Mae, are not consolidated into the Financial Statements of the United States, but a treatment similar to the one utilized for the PBGC may well be appropriate in expanded budgetary aggregates.⁴⁰

Military, Civilian and Veteran Benefits: To the extent that these benefits arise out of past employment or military service their value should be recognized as part of the government's cumulative financial burden and the accrual of new benefits and implicit interest on previously accrued benefits should be added into a comprehensive measure of changes in financial burdens.

Mandatory Spending: Here, I think, the application of accounting definitions is complex and probably varies from context to context. The case for recognition is strongest with respect to the Social Security program: benefits are based on years of labor-force participation and fixed by statutory formula. Political support for the current structure of Social Security benefits is substantial, partially as a result of well-situated interest groups but also because participant reliance interests in these benefit have become quite strong, fueled by annual personalized disclosure

⁴⁰ See supra note 25. Even if one accepts that these GSE's are supported by an implicit federal guarantee, the task of recognizing such liabilities in accounting terms is complex because the scope of the potential liability is large but the probability of payment being required is low. Accounting for other low-probability, high-impact events – such as nuclear accidents or extreme natural disasters – present similar difficulties.

statements reporting projected benefit levels.⁴¹ In some respects, the Medicare program is similar in that the receipt of benefits is tied to labor force participation and payroll taxes, albeit much more loosely than is the case with Social Security. The benefit levels are, however, not as well specified as Social Security, and have been changed on numerous occasions in the past. While the scale of Medicare program commitments is staggering, quantifying their probable economic impact is more difficult.⁴² Finally, there are a host of other mandatory spending programs. The range of programs is so broad that it is difficult to make categorical statements, but for the most part eligibility for other benefits depends not on past service or the payment of earmarked fees; rather eligibility depends on current status when the benefits are received. Thus the future economic sacrifice of these programs does not generally arise out of past work experience in the same way the Social Security and Medicare benefits do. Thus, one could quite easily imagine a system of budgetary aggregates that quantifies the future costs of Social Security and Medicare but not the costs of most other mandatory spending items.

Discretionary Spending: Finally, one might ask whether budgetary aggregates should quantify future economic sacrifices projected for various forms of discretionary spending. This point is typically made in the form of a rhetorical challenge: “Why not calculate the cost of future federal spending on education or transportation if you are going to make those calculations for Social Security?” The answer here is, I think, two fold. First, like some forms of mandatory spending, most discretionary spending does not arise out of past transactions. Rather, future discretionary spending is based on future status and transactions. A second justification for distinguishing between discretionary spending and some social insurance programs is the fact that our levels of discretionary spending do fluctuate a good deal more over time than do our levels of annual outlays for major social insurance programs such as Social Security and Medicare. Thus,

⁴¹ See Howell E. Jackson, “Accounting for Social Security Benefits,” in BEHAVIORAL PUBLIC FINANCE (2006) (Edward J. McCaffery & Joel Slemrod, eds.).

⁴² In its recent preliminary draft on social insurance, a majority of FASAB members have voted in favor of recognizing Medicare obligations once participants have satisfied statutory requirements of working for 40 quarters. See supra note 29.

the future economic sacrifice for discretionary programs is not nearly as probable as that of social insurance programs. If one plots federal spending as a percentage of GDP over long periods of time, there is considerably more variation in categories of spending that are subject to annual discretionary allocations as compared to those that are funded through more permanent mandatory spending. Education spending, dependent as it is on annual appropriations and continuous political support, varies considerably over time. The growth in Medicare spending as a percentage of GDP, in contrast, has been consistent and persistent. More generally, if one compares annual fluctuations in all major areas of government expenditures, the two major social insurance programs – Social Security and Medicare – stand apart from all other functions in claiming either stable or increasing shares of federal spending over multiple decades.

Finally, let me conclude with a word about potential connections between accounting reform and substantive reform of underlying social insurance programs. Among budget policy makers, much has been written about long-term fiscal imbalance, focusing particularly on entitlement spending. Most experts agree – and I certainly do not dispute – that any sensible solution to our long-term fiscal problems depends on addressing (read reducing) entitlements to some degree. Against this background, one might plausibly object to any accounting reform that would recognize social insurance spending as an existing obligation of the federal government. This objection to the expansion of budgetary aggregates proceeds not on theoretical grounds but simply out of a pragmatic fear that recognizing these liabilities will make it more difficult to adjust them downward.⁴³ While I am not entirely unsympathetic to this line of argument, I also think there are two important countervailing considerations. First, the current recognition of unfunded social insurance costs is apt to focus political attention on the present magnitude of these obligations in a way that long term projections focusing on budgetary imbalances two, three or even four decades in the future cannot. Second, by including the continuing accretion in these obligations over the next five or ten year horizon, my proposed approach would give Congress and the President a short term

⁴³ See, e.g., Peter Diamond & Peter Orszag, *Accrual Accounting for Social Security*, 41 HARV. J. LEGIS. 173, 175 (2004).

target against which they can measure success.⁴⁴ So, for example, political leaders might aspire to cut the ratio of financial burden to GDP from 281 percent at year-end 2005 to 200 percent by year-end 2010.⁴⁵ It is conceivable that this target could be met with only modest reductions in outlays for social insurance over the next five years. For a combination of these and related reasons, I think that it is plausible that the recognition certain off-balance sheet obligations that are not currently reflected in current budgetary aggregates or even the current Financial Reports of the U.S. Government might actually improve the prospects for meaningful entitlement reform in the next few years, rather than having the opposite effect.

Conclusion

The measures of federal fiscal performance that dominate public debate over budgetary policy are substantially incomplete and omit the financial impact of many governmental activities. Broader measures of financial performance are, however, available and could be used as a basis for more complete presentations of the financial postures of the federal government. Were these new measures to become the basis of public discourse of federal fiscal policy, the benefits could be substantial, both in terms of improving federal spending decisions and clarifying the fiscal challenges that this country faces.

⁴⁴ For a sketch of how such goals might be set in the context of Social Security, see Howell E. Jackson, *The True Cost of Privatizing Social Security*, TAX NOTES, Jan. 3, 2005, at 109. See also Jackson, *supra* note 28, at 134-36

⁴⁵ Several years ago, Senator Lieberman proposed legislation that would have created a point of order with respect to legislation that increased the country's fiscal gap about certain percentages. The logic of this point of order is similar to the point I make here. But rather than depending on congressional rules, my approach would rely on public debate and political processes to monitor broader budgetary aggregates. For an overview of the Lieberman proposal and related issues, see Trenton Hamilton & Matthew Scogin, *Broader Budget Aggregates: Proposed Reform Legislation* (May 4, 2005) (available at <http://lawweb.usc.edu/cs/p/conferences/fiscal%20challenges/documents/14-BroaderBudgetAggregates.pdf>).