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BEYOND THE POLITICAL HORIZON: the Comptroller General on the Federal Fiscal Future

At the third plenary session on Friday morning, conference attendees had the good fortune to listen to David Walker, the Comptroller General of the United States. As he remarked during his presentation, the country is at a new crossroads, with the end of the Cold War and the beginning of what is expected to be a lineage of budget surpluses. We should not get too excited, however, about the future, with a demographic tidal wave just ahead compounded by Washington's tendency to settle for myopic and tunnel vision. "Challenge for the Future," the theme of Mr. Walker's presentation, made us aware of the significance of the wave in front of us.

Drawing on several visuals, Walker showed that the projected federal budget surpluses are expected to return to deficits over the longer term, so long as there are no policy changes. But policies can and do change, and with them goes the reliability of budgetary forecasts and the winners and losers of budgeting. For instance, in 1963, 60% of federal outlays was discretionary, compared to just 30% today. The distribution of federal

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spending also has changed significantly, with defense being the big loser from 1974 to 1999 (dropping from 29% to 16% of spending) and health being the big winner (more than doubling, from 8% to 20%).

Against this budgetary backdrop Walker revealed a social tidal wave that cannot be ignored. The population is aging. In 1951, 16 people paid in for each person receiving benefits, and in a few short years that ratio is expected to decrease to 2-to-1. Walker stated that because of the population dynamics, the challenge facing elected officials is to sustain the wellspring of the benefits, the Social Security Trust Fund. Unfortunately, Walker was disappointed by the lack of progress in making the fund sustainable.

He was even more frustrated by the fiscally disparate Medicare system. Whereas the Social Security Trust fund is quite fixable, Medicare projections are based on suspect assumptions and the fiscal shortfalls require deeper policy and program reconstruction. Without significant changes, the adverse fiscal effects of the demographic tidal wave on Social Security and Medicare will be quite visible by 2011, a date just beyond the political horizon.

Walker then put this discussion in a broader policy perspective. For instance, in the short term, political gridlock may prevent Congress from passing big spending programs, allowing the debt to be paid down; but in the long run, such gridlock may stymie legislative efforts to make the policy changes needed to keep on track. Policy changes also are needed to help keep in check spending as a percentage of GDP, allowing officials to honor their fiduciary obligations to use taxpayer resources prudently. Finally, more systematic and rigorous review of existing budgetary claims are needed to make federal budgeting more responsive to emerging needs.

...continued on back page

SURPLUSES AS FAR AS THE EYE CAN SEE

Notes from the second plenary, October 6, 2000

Paul Posner, ABFM Chair, Moderator
 Rudolph Penner of Urban Institute
 Tim Penny of Concord Coalition, former
 Minnesota congressman

Posner:

We seem to have gone from unending deficits to unending surpluses.

Penner:

We do have a surfeit of surpluses. As Bill Archer (R-TX) said, "The surplus is just out of control." Watching the waning days of this Congress, one almost yearns for the days of deficits. If we had said we'd have a 2% GDP surplus and Congress would not use it up in a nano-second, I would have thought you had been smoking something. Yet candidates have great plans for the surplus and reducing debt. We should be humbled by remembering how far off our previous projections have been. No one really has a clue what will happen precisely over the next ten years. The main reason for the surplus was GDP growth without inflation, and greater than expected revenue increases. Part of the reason was unexpected capital gains growth. Recall that the Cold War ended, and this has been a singularly benign period domestically. Outside of defense and interest, the budget in 2000 is about evenly split between elderly and everything else. Elderly spending is largely Medicare/Medicaid, which grow rapidly through time.

The most interesting economic question is, "How new is this new economy?" Our experience seemed firmly to indicate that 2% GDP growth was as large as possible without triggering inflation. Now we estimate 3%, and this crowd knows about the power of compounding. Some even say CBO has been too conservative.

There has been a dramatic change in congressional spending. If accounting tricks are removed, FY 2000 may have been the greatest expansion of discretionary in recent memory. I don't know yet if Congress has pulled it off, nor am I sure the Congress understands. My impression is a nominal 6% (real 4%) growth is occurring over the last two budget years. If so, this change could eliminate about 40% of the projected surplus. If a program or service is not mentioned, we assume no real

growth; however, those programs often have real growth. So I am skeptical of surplus projections.

Turning to entitlements, it is surprising that Congress has not used up the entire surplus. Knowing how hard promises are to reverse, one might expect reticence for new benefits for the elderly, but both presidential candidates did so. Bush voiced the need to reform Social Security and Medicare. Gore's approach to Social Security may be more radical than it appeared: he would break the tie to payroll taxes by pouring in general funds. Neither Bush nor Gore provided details on financing their Social Security changes. Without reform the elderly will continue to crowd out other claimants, such as defense and the poor. A major feature is the shredding of the 1990 rules of spending caps. The Pay-go rule has indeed been made obsolete. Its prohibition against increasing deficits is producing a consequence of preventing Congress from using the surplus. There is some possibility of having no rules at all as we go forward. There is a new informal rule: thou shalt

not spend the Social Security surplus—the famous lockbox.

Any rule based on a numerical target will jump around a lot, not primarily for policy reasons. A pessimistic CBO projection will create extraordinary difficulty for the Congress. The next president will likely face a very benign budget environment, which will make discipline very difficult. Divided government may cause gridlock at a time when we need to make the reform necessary for the retirement of the baby boomers. The worst of all possible worlds would be where we decide to borrow to cover the 2030 deficits.

Penny:

Holding the line on spending is increasingly difficult with magical surpluses coming at you. Note also that no one is controlling Ventura.

In Congress, I felt that an honest budget would force some priorities. But without deficits, the Republicans seemed to have lost traction. I wanted to just bite the bullet once with a balanced budget and talk realistically about priorities. I am having trouble adjusting to surpluses as far as the eye can see. The 1997 Balanced Budget Act expected balance in 2002 only with real reductions. Now CBO projects \$4.6 trillion over ten years.

The most interesting economic question is, "How new is this new economy?"

~ Rudolph Penner ~

SURPLUSES ...continued

On average, their five-year projections have been off about 13 percent. Most past inaccuracies arose in economic and technical adjustments from changes in the large economy. Suppose the projections are wrong; this level of error would eliminate most of the surplus by 2005. Defense as a percent of GDP is lower now than before Pearl Harbor. Discretionary spending as a percent of GDP is as low as 1965. So there is pressure to do more in these areas.

If both grow annually enough to retain GDP share, we will look at general fund surpluses that are fifty percent smaller than present projections. And we have already begun down this path with "emergency" spending. This year an expected omnibus bill is likely to be higher than caps. Concord Coalition analyses

conclude that Congress will increase discretionary spending at an average rate of 5.5 percent. Spending patterns will change projections even without a new president's input. Both candidates have plans for the entire surplus. Of course, no one believes either candidate would be totally successful in driving Congress in his direction. Whichever candidate wins, you can assume there will be some tax cuts, changing the projections.

The entitlement juggernaut: demographic projections over the next thirty years should give you pause. The working age population stays level while the elderly population grows substantially. Worker to retiree ratios are changing. Just looking at health care, these growth patterns may generate annual 10 to 11 percent growth rates, vs. the seven percent in our projections. Elderly require more doctor visits and hospital stays than others, and many have chronic health conditions. The fast-

est growing segment of the population is the 85 and older group. They each cost \$6,603 per year now. Raising the Medicare age to Social Security could save 6 percent. On the other hand, Gore is talking about younger people buying into the system. In Minnesota, 50 percent of Medicaid costs go to the elderly.

In conclusion, there is much about the new economy that is different from the old economy, and that is a source of some confidence. But our experience is limited, and

caution is preferred. Gridlock has largely saved us from more expensive new spending, but those pressures will continue, and both candidates have spending agendas. Previously, we had the draconian Gramm-Rudman-Hollings Act and more sophisticated Pay-go rules in the 1990s. We need to develop some sort of

budget process that gets us to take a longer view. Just as Reagan and Clinton challenged us to change, the next president will also.

Questions and Answers:

Do you expect another multiyear budget deal?
Penny: Not now. Penner thought so.

Penner suggested we wait a bit before we spend the projections, and he does not think we should pay down all the debt. The Fed and foreigners hold more public debt than before. Debt is useful for prudent investors. Penny is more inclined to urge paying down and eliminating debt, but conceded Penner's point on keeping a little debt around. Big debt incurs enormous interest costs. Penny would prefer using the Social Security surplus to begin transitioning to a new system.

~ Wes Clarke ~

I am having trouble adjusting to surpluses as far as the eye can see. Suppose the projections are wrong; this level of error would eliminate most of the surplus by 2005.

~ Tim Penny ~

IAN AXFORD (NEW ZEALAND) FELLOWSHIPS IN PUBLIC POLICY

The Commonwealth Fund of New York invites applicants for the 2002 Ian Axford (New Zealand) Fellowships in Public Policy. The deadline for the receipt of applications is March 15, 2001. The fellowships give outstanding American professionals at a mid-career level the opportunity to study, travel, and gain practical experience in public policy in New Zealand, including first-hand knowledge of economic, social and political reforms, and management of the government sector. The program aims to reinforce New Zealand/United States links, improve public policy development by the cross-fertilization of ideas and experience, and build up a network of public policy experts on both sides of the Pacific. Applicants must be U.S. citizens and submit a formal application. For information and an application, contact: Robin Osborn, The Commonwealth Fund, One East 75th Street, New York, NY 10021-2692 (telephone: 212.606.3809, email: ro@cmwf.org), or see the Commonwealth Fund's World Wide Web home page (<http://www.cmwf.org>).

FROM THE CHAIR

For my last column as the chair, I would like to spend some time celebrating recent strides made by ABFM in serving our members. First, we have just completed our annual conference in Kansas City and it was successful beyond our own initial hopes. As the first conference held by the section outside of Washington, we had more panels than ever before, with full coverage for over two and one-half days, offering greater opportunities for panel and paper presentations to our members. Second, we gained new attendees from both the Midwest and even beyond, thereby giving us exposure to new potential members ranging from universities to local and federal regional financial management officials. I am pleased to report that the success of this conference inspired several of our members in other regions to think about hosting the conference in new venues. Our plans are to hold the conference outside of Washington every other year, so the 2001 conference will be held again in Washington. The Kansas City conference was really the brainchild of Kurt Thurmaier who followed through with tireless energy and devotion to make this a successful experience for all concerned. The leadership award he received is a small token of how much we owe to Kurt for this meeting as well as for his continuing editorship of our newsletter.

Second, our journal has been successfully transferred to Blackwell Publishers. Members have already seen a distinctly updated facelift for the journal itself. We also can look forward to a regular publishing schedule and enhanced professional support by Blackwell, including broader exposure of both the journal and ABFM at a variety of professional meetings and conferences.

Third, we have reversed the decline in our membership, thanks to an extensive membership campaign orchestrated by Alfred Ho and others. Our new institutional and ABFM-only upgraded membership category have been gaining members and we are continuing to promote these in mailings and meetings of federal, state and local budget and financial management associations.

Our capacity to serve our members will be enhanced by several other initiatives in the works. First, we plan to finalize agreement on the secretariat function. We are negotiating with the Martin School at the University of Kentucky, our sole applicant for this function. We have already enhanced our web site with the help of Merle Hackbart and Robert Eger and have charged a group led by Beverly Bunch with the task of exploring approaches to make our site more useful to researchers and practitioners alike. Finally, we are actively working with the conference planners of the ASPA 2002 national conference in Phoenix to ensure the presence of top quality panels;

both myself and Emerson Markham represent the section and will be seeking proposals from ABFM members for panels and papers for that meeting.

As some of you know, our Chair-elect, Hank Huckaby, regretfully announced that his recent promotion to the vice presidency of the University of Georgia would prevent him from devoting the time required to serve as our Chair. In accordance with the bylaws, the Executive Committee appointed a new Chair-elect at the Kansas City conference which was announced at our general membership meeting there. Our new Chair, who will formally assume office in January 2001, is John Forrester. As many of you know, John is a distinguished student of public budgeting and finance who served for many years on the faculty of the University of Missouri. I am pleased to report that John has made the jump over to the practitioner world this past fall and now works with me as part of the Budget Issues group at the U.S. General Accounting Office. John has hit the ground running and already has a number of exciting new initiatives under way which he will discuss with you in the next newsletter.

As the governance of our organization continues to evolve, we have found it advisable to undertake several formal and informal changes. On the formal level, to ensure a smoother transition in the future, the Executive Committee has approved an amendment to our bylaws providing for the election of both a Chair and a Vice Chair next year, much as is done by other organizations. The Vice Chair would serve an entire year after his/her election as an understudy to the chair before assuming full responsibilities, thereby providing a greater learning curve and more help to the Chair. On the informal level, we found the separation of duties between the chair and the conference program coordinator to be quite useful in permitting the chair to focus more on the longer term strategic issues and the conference coordinator on the shorter term tasks required to provide for a successful conference. Accordingly, we plan to continue this division of labor in 2001, with Rebecca Hendrick of the University of Illinois at Chicago serving as 2001 conference coordinator.

On a personal note, I want to conclude by thanking many of you for your assistance in carrying ABFM forward for another year. ABFM is a vital organization with a large network of people that care deeply about improving our services, volunteering not only their ideas but also their own labor to get things done. I have enjoyed working with so many of you and look forward to continuing to help John in the coming year.

~ Paul Posner ~

FISCAL TRANSPARENCY AND REFORM

October 5, 2000 at Marriott Country Club Plaza, Kansas City, Mo.

Fiscal transparency and reform were not early concerns for international financial institutions (IFIs) according to Mr. A. Premchand. Addressing the first plenary session of the 12th annual ABFM conference, Premchand noted the first IFI role was to provide advice and training only to those nations that asked for it. However, the oil price hikes of the 1970s created pressures for more active roles from IFIs such as the International Monetary Fund, the development banks and bilateral agencies.

Premchand, a retired IMF director, said that the early technical assistance role changed in the 1970s and 80s to one that emphasized improving the financial management of the recipients. Loan receipt became conditional upon the recipient's acceptance of fiscal transparency and reform. Now "conditionality" and "financial management" have become controversial.

While there were positive contributions, such as promulgating standardized financial information, there was also a negative side to the active roles of the IFIs. According to Mr. Premchand, there was a non-deliberate assumption that "one size fits all" and that the western industrial model would work as well elsewhere. The IMF would like most operations centralized to aid continuity and transparency, and for similar reasons the World Bank also advocates centralization despite its slogan of decentralization.

Some reform is underway and more is needed. There is a new paradigm driving the IFIs. It is that every country must have legislation about fiscal responsibility and an emphasis on its legal system. Transparency and responsibility may be provided without the necessity for a central payment system. The IFIs should make their operations less expensive. Mr. Premchand concluded that transparency and financial responsibility were not new ideas so we have a reason to be wary when it appears that they must be reemphasized now.

Professor John Mikesell examined the application of the standards of the IMF's fiscal transparency model to state governments within the U.S. He agreed with Premchand that IMF transparency standards focused on central governments and not sub-governments. Profes-

sor Mikesell also noted that well-developed capital markets had provided a source of discipline for state-level financial management that had produced much of the fiscal transparency desired by the IMF model. On the other hand, while state taxation data was comparable, data on state fiscal processes was remarkably incomplete. In Professor Mikesell's assessment, the U.S. national government and state governments would have a difficult meeting IMF conditionality.

In Professor Mikesell's assessment, the U.S. national government and state governments would have difficulty meeting IMF conditionality.

The accepted minimum standards of fiscal transparency include (a) clarity of roles and responsibilities, (b) public availability of data, (c) open budget preparation, and (d) independent assurance. In

the U.S. defining the boundaries of the government sector is blurred by privatization and contracting out, there is no clearly detailed statement of state roles, and earmarking of tax collections blurs the centrality of budgeting to all fiscal programs. In addition, tobacco settlement funds are seen as extra-budgetary. While fiscal information is usually available to the public in a timely fashion, difficulties in assessing tax expenditures cloud the public picture. Insofar as other openness and independence standards, state governments get most of their challenges from capital markets, rather than budgetary rules. Professors Mikesell concluded that state governments miss many of the elements of fiscal transparency rules but instead are policed by the capital markets.

~ James True ~

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BEYOND THE POLITICAL HORIZON*...continued from front page*

GAO's work points to the need to revisit programs that have been on the books for years, to reexamine their relevance, design and implementation. In particular, Walker noted the presence of multiple programs and government tools that address common goals that have not been addressed in a comprehensive, systematic way. A more comprehensive review of the federal role can build on the reforms passed by Congress in the 1990s—the Chief Financial Officers Act in 1990, the Government Performance and Results Act in 1993, and the Government Management Reform Act in 1994.

Walker concluded by suggesting a framework of questions that need to be asked in considering additional congressional oversight:

- What federal services could be better provided by the private sector?
- What federal subsidies to individuals, businesses or state and local governments are no longer needed or are poorly targeted?
- What overlapping or fragmented programs could be consolidated or better coordinated?
- What federal facilities or locations are outmoded, ineffective, or excess to requirements?
- In what ways could major capital investments be more cost-effective?

Answers to these questions should help us determine how to meet the budgetary challenges just ahead. The federal government is in good shape today, Walker added, and many people deserve credit, but the demographic tidal wave will put in jeopardy the government's fiscal health. Action is needed now so that we can gradually phase in the reforms to programs that most Americans so vitally depend on, while promoting a stronger future economy for the next generation of taxpayers.

~ **John Forrester** ~

CALL FOR PAPERS, PRESENTATIONS and PANELS

Association for Budgeting and Financial Management
13th Annual Conference, Washington, D.C.

The conference committee invites proposals for panels, papers, and presentations for the ABFM 2001 conference. Potential topics include, but are not limited to:

Budget theory	Capital and debt management
Performance budgeting	Public accounting & accountability
Budget process	Financial impacts of deregulation
Tax & revenue policy	Managing finance departments
Intergovernmental finance	Education finance
Budget innovation & reform	Capital & development financing
Public funds management	State and local budgeting
Social security finance	International municipal finance
Financial markets	Municipal securities
Current & future challenges in budgeting and financial management at all levels of government	

For full consideration, proposals should be submitted by April 1, 2001. Proposals should describe the panel, paper, or presentation, provide the appropriate titles, and not exceed 500 words. Also include the name of all participants or authors, addresses (including e-mail), phone numbers, and affiliations. Proposals may be submitted by mail, email, fax or an email link through our website at <http://www.abfm.org>.

Please send all correspondence to: Professor Rebecca Hendrick, Public Administration (M/C278), 412 South Peoria Street, University of Illinois at Chicago, Chicago, IL 60607-7064, Phone: 312/355-0305; FAX 312/996-8804; email: Hendrick@uic.edu

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