Building a Stronger Fiscal Foundation: An Agenda for 2021

Academy Election 2020 Project
Working Group:
Advance the Nation's Fiscal Health

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The Academy formed a series of Working Groups of its Fellows to address Grand Challenges in Public Administration. These Groups were charged with producing one or more papers to advise the Administration in 2021 (whether reelected or newly elected) on the key near-time actions that should be taken to begin addressing Grand Challenges. This is a paper of the Advance the Nation's Fiscal Health working Group. It includes these Fellows' recommendations for the U.S. to strengthening governments' financial management systems.

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BUILDING A STRONGER FISCAL FOUNDATION: AN AGENDA FOR 2021

A REPORT OF AN ACADEMY WORKING GROUP

NATIONAL ACADEMY OF PUBLIC ADMINISTRATION
ELECTION 2020 WORKING GROUP:
ADVANCE THE NATION'S FISCAL HEALTH

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THE CHALLENGE

Recent federal budgeting has been characterized as a series of deals between the Administration and the Congress to raise the spending caps imposed by the Budget Control Act of 2011 and to lessen the magnitude of the spending controls included in that statute. Adding to the fiscal stress resulting from that additional spending, a package of tax reduction measures was enacted that have had the effect of substantially increasing the size of annual budget deficits.

In January 2017, CBO estimated near-term annual deficits at about half a billion dollars – $1.6 trillion over the 2017-2019 period. Given higher spending caps and new tax cuts, actual deficits over the 2017-2019 period totaled $2.4 trillion, about $800 billion more than forecast. The 10-year (2018-2027) forecast at that time was for an additional $9.4 trillion to be added to the national debt. By January 2020, CBO had significantly increased its estimates to show deficits exceeding $1 trillion each year, totaling $13.1 trillion over the 2021-2030 period. Now, with the COVID-19 pandemic, the annual deficit will be $3 trillion or more in FY 2020—and possibly beyond.

The practice of routinely spending significantly more than available revenues has caused some policymakers to question whether deficits matter. The generic question, at least, returned as part of the popular discourse after the 2018 Congressional elections and again during the 2020 Presidential election because a number of candidates have proposed ambitious spending programs (e.g., Green New Deal, Medicare-for-All, major infrastructure improvement programs) that would require substantial additional federal spending—and larger deficits if not offset with higher taxes.

I. The Federal Government

Even in the pre-COVID-19 world, the United Stated faced serious current and long-term fiscal challenges at every level of government: The federal government, which spent nearly $4.5 trillion in 2019, has more than $22 trillion dollars in debt, and a revenue base unable to keep up with continual spending increases. In early FY 2020, when the robust economy's unemployment was in the 3 percent range and before the COVID-19 pandemic, federal debt was about 78 percent of GDP—or double the average over the past 50 years—with the national debt growing by about $1 trillion a year. Even with interest rates at historically low levels, interest payments on the debt will begin to exceed defense spending by 2023. Entitlements are a long-term issue, with trust funds for Medicare and Social Security possibly being depleted in 2026 and 2035, respectively. Existing spending commitments have created significant unfunded liabilities. Consequently, a structural budgetary imbalance now exists that has left the federal government's financial condition reeling from years of neglect.

Potential fiscal implications of the coronavirus pandemic

Federal policymakers have already adopted a $2 trillion emergency spending bill to reduce the economic and social costs of the COVID-19 outbreak. In doing so, they were largely flying blind because of the extraordinary nature of this shock. In contrast to the Great Recession, this event is not a financial, but a biological, phenomenon. At the macro economy-wide level, the virus outbreak is reducing both aggregate demand and aggregate supply. Demand has dropped sharply because people rationally are avoiding public and work spaces to reduce the risk of infection. This decline in demand recently contributed to the largest single-week filing of unemployment claims. Supply of goods and services is declining for the same reason. This will unequivocally reduce sales, production, employment and income, precipitating declines in consumer spending. But it is also unlikely that those underlying causes of slowing

aggregate economic activity can be offset by increased government transfer payments to individuals, purchases from producers, or tax cuts.

Rather, this stabilization effort will succeed primarily to the extent that it encourages and enables people to do what they are already doing: avoiding social contact and slowing the rate of infection. This legislation also attempts to shift scarce resources toward hospitals and medical service providers. In the short-run, supply is only weakly responsive to increases in demand and funding. Worse yet, some decrease in supply should be expected as providers themselves become ill. Yet, in the longer term, financial assistance can avoid financial insolvency of institutions that were struggling before the pandemic outbreak. Increased assistance to individuals and families will also reduce the economic hardship of those whose own resources are insufficient to permit them to deal with the financial losses that will not be equally distributed across the US population.

While individuals have strong incentives to avoid social contact and reduce their risks of infection, individual avoidance also produces social benefits from the associated reduction in risk to others. Just as the social benefits from inoculations provide an efficiency justification for public subsidies to promote vaccination, similar benefits require social sharing of the cost of avoidance, including lost wages. Increases in unemployment insurance benefits and public payments to employers to avoid layoffs are a logical means of assuring that the costs of obtaining social benefits are widely shared. A social gain might also be obtained from public financial assistance aimed at avoiding the insolvency and dissolution of complex specialized business enterprises.

It is noteworthy that the $2 trillion increase in spending is financed by an increase in federal debt—and unexpected emergencies such as the coronavirus are precisely the type of extraordinary event for which the federal government has borrowed in the past to finance an appropriate response. What is different in this case is that the federal government already has an outstanding debt to income ratio equal to its previous historical peak. That means that the risk of fiscal crisis is greater in this

instance than in previous emergencies. The source of this increased risk is broad, bipartisan agreement, that borrowing continuously to finance consumption in good times as well as bad, is preferable to requiring any living generation of beneficiaries and taxpayers to pay their own way. Clearly, an emergency is no time to suddenly get on the "fiscally responsible" wagon. But we need to note now that the dire structural deficit that motivated the establishment of this Grand Challenge panel now poses a significantly greater risk than before the emergence of the coronavirus crisis.

In the aftermath of COVID-19, it will be essential that Congress and the President put the government on a more responsible fiscal path. To get back to a sustainable budget from where we are now could take years, so interim benchmarks or targets are needed to create a manageable and sustainable path. Absent a financial or other large sector implosion, or a national emergency that negatively impacts the economy, there appears to be little public or political will to address the long-term structural imbalances of rising debt, growing spending (much of which is on autopilot) and revenue failing to keep pace with spending. On our current path, these structural imbalances will worsen in the years ahead.

Key matters to consider in assessing the impacts of deficits include the following.

- Persistent large structural budget deficits result in rising debt-to-GDP ratios and lead to unsustainable levels of debt. Current large structural deficits and high debt-to-GDP ratios are historically high given the recent long period of sustained economic growth and the looming demographic challenges of baby boomer retirement.
- Large structural deficits can limit long-term economic growth by crowding out private investment and putting upward pressure on interest rates as private borrowers are forced to compete with the government for loans.

- Rising public debt levels require a growing portion of the federal budget to be directed toward interest payments, potentially crowding out other, more worthwhile sources of government spending.
- Deficit spending can act as a drag on a full employment economy given there is a finite amount of investable resources available and deploying (borrowing) capital for public sector purposes crowds out other uses and takes those funds out of the private economy where innovation is more likely to occur.
- Running deficits has a direct impact on the economy. They can be used appropriately as a countercyclical tool during economic downturns to generate additional aggregate demand and initiate (hopefully) a virtuous pattern of public sector stimulus, more investment, new jobs and greater income leading to stronger growth. Alternatively, deficits incurred while the economy is strong can reduce national savings and weaken a country's ability to respond to downturns when they occur.

Deficits can result in a low rate of national savings if they reduce the perceived cost of government spending to taxpayers, allowing them to feel wealthier than they would if they had to pay taxes for all the current services they are receiving right now. The key drivers of the nation's increasingly unsustainable fiscal path are growth in programs driven by an aging population (major health care programs and Social Security), rising interest on the national debt, and a more general concern: the failure of the revenue base to keep up with such growth. Cutting across all of those drivers is the unmistakable fact that the fundamental nature of the budget—annual appropriations-driven discretionary vs permanent-law mandatory spending—has shifted in one direction over the past 50 years and that trend is expected to continue for the foreseeable future.

In 1970, about 62 percent of federal expenditures funded discretionary programs and agencies involved with national defense, education, transportation, housing, justice, veteran's services, and many other programs. The remainder of the budget, or 38 percent of yearly spending, was used to pay for mandatory entitlement programs, like major health care programs, social security and interest payments on government debt. By 2019, the mix had more than fully reversed with 70 percent spent on entitlements and interest expense and 30 percent going toward discretionary spending activities.

Such a shift from discretionary to mandatory spending means the U.S. cannot solve its long-term fiscal challenges by continuing to do what it has done through the first two decades of the 21st century: 1) capping discretionary spending and then passing subsequent legislation to increase the caps; 2) funding large portions of the defense budget as emergency expenditures not subject to the caps; 3) cutting taxes; and 4) mostly ignoring the growing costs of entitlement programs and interest on the national debt. That four step foxtrot is becoming a tiresome choreography continually making the country's fiscal outlook worse, not better.

A balanced budget amendment to the Constitution is clearly too rigid as it would irresponsibly lock the nation in to revenues equaling expenditures every year no matter the circumstance. Yet any deficit reduction targets short of that, whether in congressional budget resolutions or even in statute, represent a plan or a law that Congress can easily override with a new law. This is what makes it so difficult to correct the pattern of fiscal irresponsibility.

The U.S. budget process has become antiquated, cumbersome, and ineffective. To illustrate, consider that federal budget process results have produced an on-time budget only four times in 40-plus years (1977-2019), and only four balanced budgets (all consecutive during the 1990s) in that same time, while producing 186 continuing resolutions, 20 funding lapses, and numerous debt ceiling crises. Such budget process failures erode

citizen trust that that our elected officials can effectively carry out the business of the nation.

From a tactical perspective, funding delays and uncertainties adversely affect the proper planning and execution of major programs across government, imposing a hidden inefficiency tax. That process is made haphazard when agencies – due to budgets not being enacted on time – don't have operating and program budgets until deep into the fiscal year. Operating programs and getting money out the door during the course of a full fiscal year is challenging, but when those activities are crammed into a partial year, prudent financial management suffers. It becomes difficult to plan responsibly, even for relatively straightforward budget execution, much less to do the types of data, risk and programmatic analysis needed to assess agency and program performance. More certainty in the budgeting process would provide agencies with the flexibility to focus on those bigger, and in many respects, more important analytical and planning exercises.

Moreover, current fiscal and programmatic policies are putting an inequitable burden on future generations. In the years since the modern budget process began in 1977, an average of 15% of federal spending each year has been deficit-financed. Is it equitable for current consumers of government programs simply to pass on a significant share of the costs of their benefits to future generations? There are many divergent views on how best to tackle the nation's fiscal challenges spanning generations. While there is some degree of wisdom in many of the proposals that have been offered to address fiscal imbalances over the long run, they typically disagree on required policy reforms. However, nearly all agree that if current policies remain roughly in place, spending will grow at a rate over next several decades that will far exceed expected revenues, and future generations will be left to pay tab. A structural budget deficit exists because our current policies lead us down an unsustainable budgetary path, a path that will become untenable as the ratio of workers to retirees continues to decline.

The central question is: What fiscal condition do we plan to leave to our children, grandchildren and generations beyond? This question really is the crux of the matter and is ultimately a statement of our values. The notion of conducting a grand fiscal and economic experiment – let's borrow as much as we can until we can borrow no more – sounds more like the reprise of a country music song than sound public policy.

II. The US Federal System

The fiscal health of the federal government cannot be considered in isolation. States and localities account for more than one-third of all government spending. Their finances have only recently recovered from the Great Recession, and they continued to face near-term difficulties due to such factors as rising healthcare costs before the COVID-19 pandemic. Some states have cut taxes without corresponding spending cuts, while others have increased spending without corresponding revenue increases. Balance sheets for some state and local governments have a time bomb of unfunded pension liabilities that could easily crowd out public investments in such areas as education and infrastructure over the next decade.

The key features of a strong fiscal partnerships among governments are sustainable initiatives that balance revenues and spending where all parties have a common interest. To achieve that, there needs to be appropriate incentives and transparent sharing of information among the parties and the public. Incentives should not encourage over-spending or should stimulate private participation where there is private benefit.

Four major functional areas of federal grants include health care (largely Medicaid), income security, natural resources, and transportation. Some of these programs fund capital spending, while others are payments to individuals or to service providers. Recent work by Brookings, the Urban Institute and others provide strategies (such as "braiding and blending") that facilitate combining grant revenue from various sources to

increase flexibility and provide more comprehensive, holistic health care services that are focused on outcomes. These strategies have also been applied to education, income security and environmental grant programs.

The balance of cost sharing between federal and state-local governments is a critically important decision in the design of capital grants. Many federal aid programs for infrastructure were originally designed under a "one size fits all" strategy, which led to over-subsidizing some recipients and under-funding others, and not putting the right infrastructure in the right places. Flexible matching rates are becoming more common. Some infrastructure programs require recipients to perform cost-benefit analyses, which can help determine customized matching rates that can vary depending on the ratio of national benefit relative to local benefit.

Some of the key challenges facing the federal system from a fiscal standpoint are described below.

Preemptions and Tax and Expenditure Limitations. State complaints of preemption by the federal government are analogous to local governments' complaints of state preemptions. Increasingly, states have exercised their preemption rights to restrain primarily urban governments' authority. As a consequence, challenges to local autonomy have accelerated in the past decade. Tax and expenditure limitations have a similar effect on the behavior and consequences of local governments in fulfilling their responsibility of protecting the health, safety and welfare of their residents.

Fiscal base slipping from the economic base. More than a decade after the Great Recession, constant-dollar municipal general fund revenues are only now beginning to reach the levels they enjoyed prior to 2007. By contrast, states' general funds rebounded to pre-recessionary levels by 2013. Almost exactly the same phenomenon was experienced by the federal government. Cities' revenue bases have responded slower than the federal government's and the states' revenue bases, which indicates slippage.

Spatial mismatch exists between "payers" and "users" of services in governmentally fragmented areas. How we pay for government services (e.g., public safety, water, roads and bridges) ought to reflect how much we use and value those services. State and local governments should systematically evaluate the link between service delivery and the users of such services. Certainly, a revamped financial architecture must be cognizant of residents' ability-to-pay so that the most vulnerable have access to clean water, safe streets, and public safety, but it also must ensure that the beneficiaries pay their fair share to the extent they have the financial resources to contribute.

Infrastructure. The American Society of Civil Engineers infrastructure grades reflect the fact that state and local governments have effectively used infrastructure as a piggybank, bankrolling current service costs by borrowing from future generations. State and local governments must address the challenge of an infrastructure deficit caused by decades of underinvestment in maintenance and repair activities while also anticipating future infrastructure needs as technologies, transportation modes, and other factors change. Most state and local governments create a separate capital budget with funding sources that include debt. Access to municipal bond markets, aid from other levels of government, own-source revenue (especially fees) vary over time and vary by use (consumer demand).

Pensions and Other Post-Employment Benefits (OPEB). Another intergenerational problem that is not as ubiquitous as infrastructure underfunding for many states and localities is the unfunded pension and OPEB obligations. The long-term liabilities associated with pension and OPEB underfunding, which Pew Charitable Trusts estimates conservatively at more than $1 trillion, constrain the budgets of state and local governments, and threaten intergenerational inequity.

Changing demographics and budgets. States have reduced support for higher education and increased support for K-12 education, including English as a Second Language and special education. The demographic outlook is the graying of the nation. The aging of the population places higher demands on service providers for the elderly, which will demand an ever-increasing share of state and local budgets. The complication is in part that as the nation ages, work force participation declines, pushing increased costs of elderly services on a dwindling taxpaying population.

Long-term fiscal sustainability will require many difficult decisions by elected officials who will be forced to make challenging tradeoffs. Tackling these issues earlier rather than later will make it possible to strengthen the economy and meet other goals while achieving fiscal stability.

RECOMMENDATIONS

Although the nation's fiscal problems are significant, there is no shortage of proposals to begin addressing them. The six recommendations discussed below include proposals aimed at: 1) fixing a broken federal budgeting process; 2) identifying policies for long-term fiscal sustainability; 3) optimizing the performance of investments; 4) enhancing financial management and controls; 5) developing fiscally sound intergovernmental partnerships; and 6) better harmonizing federal efforts to intervene in the economy in response to the COVID-19 pandemic.

1. Fixing a Broken Federal Budgeting Process

The U.S. government responded to the COVID-19 pandemic with a series of fiscal assistance packages that will result in multi-trillion dollar annual deficits through at least 2021. Given the urgency of the perceived need, that response largely bypassed usual budgeting norms, procedures and constraints. Looking beyond the pandemic – or at least to the return of a relatively stable fiscal state – attention should be directed at instituting a revised budget process that is effective in ordinary times and better able to anticipate, mitigate, respond to, and recover from national emergencies.

Even before the pandemic, it was clear the U.S. budget process had become antiquated, cumbersome, unused, and ineffective. The current process has produced an on-time budget only four times in 40-plus years (1977-2019), with only four balanced budgets (all consecutive during the late 1990s), while producing 186 continuing resolutions, 20 funding lapses, and numerous debt ceiling crises. That performance erodes citizen trust that elected officials are competent to carry out the business of the nation – trust that is critically needed if the country is to emerge stronger from the pandemic crisis.

Funding delays and uncertainties adversely affect the efficient planning and execution of major programs across government, imposing a hidden inefficiency tax. That process is made haphazard when agencies – due to budgets not being enacted on time – don't have operating and program budgets until deep into the fiscal year. More certainty in the budgeting process would provide agencies with the flexibility to focus on strategic activities such as performance planning and assessment, effective program delivery, and the attainment of policy objectives. It would also help to restore citizen trust that elected officials can go to Washington and effectively conduct the government's business.

The COVID-19 pandemic, and the real prospect that an emergency of that magnitude could recur, presents an opportunity to consider the adoption of a more visionary, strategic, and anticipatory budget process. Policymakers must focus both on how best to deploy marginal tax (and, increasingly, borrowed) dollars, and to assure sufficient budgetary

resources are applied to realize intended public policy goals. Two recommendations to support this effort are offered here.

First, future Administrations should consider adopting a four-year strategic financial plan that would articulate a clear, mission-directed vision of resources required to accomplish specific policy objectives and guide budget formulation. The Department of Defense, which has been creating rolling five-year Future Years Defense Plans for several decades, has realized significant budgetary planning and execution benefits from having a longer-term view of its finances. Biennial budgeting, a practice used in 16 states during the 2019 legislative cycle, could also be implemented. Notwithstanding the current emphasis on year-by-year budgeting by OMB, the executive branch could revise its own budgeting procedures to have a more anticipatory, longer-term, and mission-focused budget.

Off-year activities at executive branch agencies and OMB could be directed at program evaluation and reviews including increased emphasis on mandatory programs, tax policy, and tax expenditures. These activities should be undertaken so that the budget process does not duplicate what is done during the first year of a presidential term. Modern budgeting software allows agencies to readily automate off-year requests to Congress with little staff time and input required. Using such an approach could enable the executive branch to put more analytical emphasis on critical needs (anticipatory), consider longer-term funding needs and revenue sources (sustainable), and more closely scrutinize whether programs and policies materially achieve their missions (mission focused).

While such a plan will likely be met with stiff resistance in Congress – which prefers to exert control by providing most funds on a year-by-year basis – a less frequent (or at least less intensive) budget cycle could free up the legislative branch to provide better oversight of programs and executive branch operations and to address more proactively other challenges facing the country. While not a panacea for all current budgeting shortcomings, such a move to reduce the time spent on annual budget debates and development could drive considerable efficiencies across both the executive and legislative branches.

Second, the federal government should more clearly articulate, anticipate, and budget for its crisis finance and management roles. Catastrophic 21st century events such as 9/11, Hurricane Katrina, the 2008 financial crisis, and the COVID-19 pandemic have made clear that the unexpected happens. Whether involving military, humanitarian, financial, or technical and scientific leadership and assistance, the application of substantial budgetary resources can mitigate social harm. In the past, however, policymakers have done little to plan for low-probability, high-consequence events – notwithstanding that they are occurring ever more frequently.

Given the pace of crises of all sorts affecting the U.S. in the 21st century – and the tendency to provide increasing levels of resources to address them – there should be a more systematic and transparent recognition of potential budgetary consequences. Risk-adjusted costs arising from the government's role in this regard should be recognized and reserved in the budget, not unlike rainy day funds used by state governments. Moreover, a federal countercyclical program could be created to leverage such funds that would be triggered in the event of extreme circumstances, such as a recession or pandemic. At a minimum, such an approach would ensure the government is mindful of such risks and is planning for such eventualities.

2. Fiscal Sustainability

U.S policy makers initially responded quickly and appropriately to support the economy during the economic contraction resulting from the rapid contagion of COVID-19 and the social distancing needed to slow the spread of the pandemic. While the sums obligated were the largest ever to address an economic shock, never had the country experienced an abrupt withdrawal of such a large share of the labor force from the workplace. The suddenness of the event and the urgency of the need left the government with no choice but to borrow massively to sustain the nation's productive capacity.

Once the health concerns have been mitigated, we will need to shift our focus to identifying equally effective, follow-on policies for longer term sustainability. One essential feature of a strategy to enhance resilience to future shocks, ironically, will be to continue our current, virus-induced practice of reduced consumption. That is, we will need to save a larger share of post-pandemic income than we did before this public health crisis.

In the simplest terms, the COVID-19 virus has sharply lowered standards of living because we had saved too little to sustain our lifestyle during a temporary loss of production and income. It is as if a farmer had saved too little of a year's crop to avoid the deprivation of a famine. As a society, we have consumed more government-provided benefits than we were willing to pay for in taxes. Instead we have financed a significant portion of our "good life" by borrowing from future generations.

Going forward, we need to flatten this debt growth curve by planning more effectively for unknown, but certain, future shocks to our well-being. As a society, we need to save and invest in assets that will continue to deliver resources and benefits in the face of a variety of threats such as war, health crises, geophysical shocks, and adverse events beyond our imagination. We also need to address the public debt that exceeds the combined annual income of every living person in this country.

In sum, we must recover an appreciation of the reality that resources are scarce; that we are all pulling on the same blanket. We need to stop pulling, get up, and either find more blankets or make this one bigger. Going forward, our spending and revenue policies should be designed to grow our economy and the productivity of our workforce while being mindful of the need to live within our means while doing so.

Some specific, immediate policies, such as the Bipartisan Congressional Budget Reform bill,[1] that could improve our ability to deal with future real and financial shocks include:

- **An intergenerational debt relief surcharge**, consisting of a small personal and corporate income surtax in 2020 (e.g., <0.5%) that automatically and gradually increases as the infection rate of COVID-19 recedes. The modest revenue collected from the levy would not be a drag on the economy but would effectively commit the current generation to bearing some of the costs of relief incurred during the pandemic.
- **A budget policy of planning for fiscal emergencies** through a mandatory annual outlay of the expected cost of urgent, unexpected events, as estimated by the Congressional Budget Office, to a budget stabilization reserve fund. Fund balances would be available to pay such costs without further legislative action. ,

[1] The bill, (S. 2765, 116th Congress) according to the US Senate Committee on the Budget, would incorporate "debt-to-Gross-Domestic-Product (GDP) targets into the budget resolution and the budget process, adopt biennial budgeting while keeping annual appropriations, link debt limit increases and discretionary spending caps to passage of a budget resolution, and add transparency requirements such as including interest costs in Congressional Budget Office (CBO) scores."

To regain and sustain an enduring way of living, we must accept responsibility for addressing both the immediate biological threat of deadly infection and the less tangible one of our own fiscal policies.

3. Investments Criteria

For decades, the de facto decision criterion for federal investments – defined here as investments in highways, water systems, airports, and other infrastructure assets – was that those investment ought to yield higher returns than an equivalent private sector investment.[2] This criterion was based on the assumption that the pool of investment capital is finite. Every dollar of additional federal investment, either from current taxes or borrowed, is a dollar not available for private sector investment. A corollary is that every investment in one region or project happens at the expense of another region or project. Conventional wisdom has held that investments capable of meeting the "greater returns than the private sector" criterion are the most likely to successfully balance across these difficult trade-offs.

But that criterion is rarely applied in theory or practice. There are sharp disagreements over how to measure return on investment, and parochial political dynamics often drive federal investments toward politically popular projects that produce less-than-optimal economic effects. The result is an uncoordinated, inefficient, zero-sum game that has left our national infrastructure in uniformly bad condition.

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[2] Returns in this context have been broadly defined to include economic growth, productivity gains, and human capital accumulation among many other measurable improvements.

Yet the old assumptions may no longer apply under all circumstances. For more than a decade, interest rates and inflation have both held at record lows despite unprecedented new federal government borrowing. This suggests the pool of investment capital, especially from debt financing, might not be as finite as once thought. Meanwhile, as the country has grown and local economies have simultaneously diversified and specified, so too have regional infrastructure needs and the federal government's role in helping to meet those needs. Federal investment in one region need not necessarily happen at the expense of another region if both regions' investment needs are quite different.

All this suggests a new key criterion that could drive federal investments going forward: Investments should seek to optimize an asset's long-term performance. Infrastructure assets are essential to grow local economies, support community development efforts, and move people safely throughout a region. And yet, these goals are only background considerations when the federal government defines its investment priorities and measures infrastructure performance.

This new criterion has several advantages. First and foremost, it is consistent with recent state and local experiences with public-private partnership models that successfully incentivize the condition, safety, and economic impact of infrastructure assets over time rather than simply building new infrastructure at the lowest possible cost. It also acknowledges differences in how infrastructure is built and maintained across the country, and the tremendous differences in how the federal government partners with states and localities throughout the investment process.

This approach would require a few immediate practical steps for OMB:

- **Define thorough and standardized life-cycle cost analysis**. Federal agencies should extend and standardize life cycle costing standards for infrastructure assets. The Department of Transportation and the Defense Department's Cost Analysis and

Program Evaluation (CAPE) team have developed a variety of infrastructure cost analysis methodologies that could serve as models for other agencies. New government-wide life cycle costing standards could be the foundation for better decisions.

- **Develop comprehensive asset management strategies**. A comprehensive asset management strategy would include key performance indicators, estimates of the costs of given performance levels, and estimates of financing and funding sources available for specific investments funded by fuels taxes, tolls and other revenues. Investments expected to produce and sustain a desired level of performance over time given the available financing and funding are most likely to pass the long-term optimization criterion. Note that asset performance could include a variety of region-specific performance measures and infrastructure delivery models.
- **Leverage New Technology to Optimize Efficiency and Reduce Costs**. Recent technological advances have transformed large segments of the infrastructure industry. The "internet of things" makes it possible to decentralize infrastructure monitoring and reporting literally to the ground level. Distributed infrastructure systems in areas like electricity transmission allow individuals and businesses to both use and contribute energy to the grid. Vehicle monitoring systems allow drivers to pay for road use by the mile rather than through fuels taxes. These technological advances allow investments to serve more people with a greater degree of efficiency and effectiveness than ever.

4. Enhance Financial Management and Controls

As we emerge from the devastating impacts of the pandemic, both in human costs and economically, there are mechanisms we can use to better assure transparency and accountability in budgeting in dealing with program costs over the long-term. We can also look to the federal agencies and departments for contributions they can make in supporting the nation's long-term fiscal health.

Expand the use of accrual accounting for long-term federal liabilities. Currently the federal budget uses a cash-based approach to account for most program costs. Such an approach can often understate commitments affecting future budgets. A change to bring more transparency to the long-term obligations would be to adopt accrual basis budgeting for deferred cash payments.

An accrual approach, which records the net present value of these commitments in the year they are made, regardless of the actual flow of cash payments, could more accurately reflect future obligations for select programs. With the enactment of the Federal Credit Reform Act in 1990, government loans and loan guarantees shifted to an accrual accounting and budgeting methodology to reflect the estimated longer-term costs of defaults and interest-rate subsidies provided by the government.[3]

As CBO has noted[4]: "Cash-based estimates used in the budgeting process generally reflect costs over the 10-year period on which the process focuses, but that period may not be long enough to capture the full extent of some activities' effects. Accrual-based estimates that consider

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[3] "The Better Budget Process Initiative," The Committee for a Responsible Federal Budget

[4] *Cash and Accrual Measures in Federal Budgeting* (January 2018), www.cbo.gov/publication/53461. p. 1.

long-term effects provide more complete information about programs that involve longer time frames. Such estimates could give lawmakers a tool to use in setting and enforcing targets for long-term deficit control because, for the purposes of Congressional budget enforcement procedures, legislative proposals would receive credit (or be charged) within the 10-year budget horizon for the ultimate effects of provisions that would save (or cost) money over a longer period."

Accrual treatment is particularly relevant for those commitments that are long-lived and mandatory including federal pensions, health benefits, long-term insurance programs and environmental clean-up costs.

Tighten controls over obligations.[5] Obligational limitations are designed to control the federal government's exposure to spending requirements. Budget authority constitutes the most common limit on obligations. However, various practices minimize the upfront use of budget authority in order to circumvent limits (e.g., structuring capital leases to look like operating leases, cash instead of accrual-based accounting for deferred payment programs, annual funding for multi-year projects, etc.). Restrictions on such approaches would help to reduce back-door spending pressures that often escape full disclosure in the current budget process. More uniform practices would also create a more level playing field between competing priorities.

[5] National Academy of Public Administration Forum on Fiscal Futures: The Role of Budget Process and Concepts, and Academy Fellow David Mathiasen's paper, The Fiscal Challenge: Federal Budget Concepts and Practices.

Federal agencies have opportunities to contribute toward fiscal health. Public agencies and administrators have an important supporting role to play in advancing the nation's long-term fiscal health. For example, they can identify more effective ways of managing the public's business to help prioritize spending and tax policies by advising elected officials on fiscal options and impacts; educating, informing, and engaging the public about these issues; and using evidence-based approaches, including rigorous evaluations of existing programs to determine which ones are worthwhile investments.

Executive actions alone cannot put the federal government on a sustainable fiscal path, but they can contribute to it. In testimony[6] before the Senate Budget Committee, Comptroller General Gene Dodaro noted steps federal agencies could take to contribute to a sustainable fiscal future including reducing improper payments (which agencies estimate totaled $175 billion in fiscal year 2019); addressing the $381 billion annual net tax gap; better managing fragmentation, overlap, and duplication across the federal government; and improving information on federal programs and fiscal operations to aid agency decision-making.

5. Recommendations for Fiscally Sound Intergovernmental Partnerships

The need for strong fiscal partnerships among governments has never been more urgent. The economic impact of the recession induced by COVID-19 runs the risk of becoming a depression without swift action. Yet, as important as it is for the federal government to stimulate the economy immediately, it is of crucial importance that the funds be used wisely. Federal partnerships with state and local governments are a key tool for effective interventions.

[6] Statement of Gene L. Dodaro Comptroller General of the United States (GAO-20-482T) March 12, 2020

The timing has never been better for a major federal program to improve infrastructure. Unemployment has spiraled and interest rates are low. The multiplier effects of construction spending are high. Not only is there an urgent need to improve a wide variety of infrastructure - including public health systems in the wake of the pandemic - both presidential candidates in 2016 called for a major infrastructure program, indicating a rare consensus between the two parties.

The ability of the federal government to run deficits and stabilize the macroeconomy makes it a key partner. Local governments have capital improvement programs which identify the most important community needs. State agencies can be key conduits to target funds to the highest needs. They also have their aid programs for highways, airports and transit, infrastructure banks, and revolving loan funds.

The major needs for infrastructure improvement are in transportation infrastructure, water supply, wastewater, energy, and flood control. The Academy's Grand Challenge in Public Administration, Create Modern Water Systems for Safe and Sustainable Use, highlights the difficulties with the nation's aging water infrastructure – the issues discussed there are relevant to this set of recommendations. In the area of transportation there is a need to repair and expand highways, improve and expand transit, and improve rail and port connections for freight. Flood control is increasingly important with the changes caused by global warming.

As the economy recovers, federal aid can shift from providing funds to leveraging state, local and private funding. Improvements that benefit businesses should require private financial support. Where appropriate, user fees can be part of the financing plan. Revolving loan funds and state infrastructure banks can reduce the demand on tax funding and encourage recipients to prioritize projects. Where possible, a new administration should move funds to programs that encourage broader sources of revenue. Over time, policies should be changed to encourage federal assistance as opposed to federal financing.

6. Federal Intervention in the Economy in Response to Coronavirus

After over four decades in which deficits averaged about 2 percent of Gross Domestic Product (GDP) and the public debt averaged about one third of GDP, the United States entered the Great Recession a decade ago with public debt at nearly 40% of GDP in FY2008. The debt to GDP ratio then rose to 60% in just two years, and the U.S. exited that crisis with debt having risen to 70% of GDP by the time the Budget Control Act took effect in 2012. Despite that effort to control discretionary spending only, plus a decade-long economic recovery, by the time the coronavirus pandemic hit, the U.S. public debt had risen to 80% of GDP.

This left our nation poorly positioned for the devastating economic and fiscal impact of the coronavirus pandemic, which has, in just a few months, completely altered our economic situation in the near term and our fiscal situation for much longer than that. Preliminary estimates by the Congressional Budget Office (CBO) are a deficit of $3.7 trillion in fiscal year 2020, far exceeding the highest deficits previously recorded, and at 18% of GDP the largest relative to our economy since World War II. CBO also projects that the public debt will exceed 100% of GDP by the end of this year and grow larger still after that.

As with any national economic crisis, the lead role in our response rests with the federal government, which has economic tools – including monetary policy and borrowing authority -- to stimulate or stabilize the economy that state and local governments do not. We look to the federal government, including the Federal Reserve, as the primary source of macro-economic relief.

Unlike the financial crisis of a decade ago or the Great Depression ninety years ago, the root of this crisis does not lie with trade policies, asset price bubbles, or business cycles. The current economic crisis is at its core a public health crisis. The states have by and large taken responsibility for the public safety decisions, most notably stay-at-home orders and school closures, that are directed at controlling or preventing the spread of the virus. The federal government and the states have had shared, and at times conflicting, roles in their response to this underlying health care crisis. For example, the purchase and distribution of medical supplies for health care workers and the treatment of those already infected were both shared and discrete.

Given this shared and divided set of responsibilities, close federal-state coordination is essential to minimize the spread of the virus and the resulting number of fatalities and illnesses, as well as to craft appropriate economic responses. Yet at the end of the day, only the federal government has the tools at its disposal to cope with the large-scale economic impact.

The federal economic response to this pandemic has had two primary branches: fiscal policy in the form of legislation (and to a lesser extent regulatory actions), and monetary policy actions by the Federal Reserve. That combination is not, by itself, unusual. However, the unique aspect of the response to this current crisis is that it is not a classic counter-cyclical one. The near-term goal in this situation is not to provide an economic stimulus (for example, to get more people working immediately) but rather simple economic relief, to allow people to stay home from work without losing their homes in a situation where avoiding the spread of a contagious disease, not a lack of demand, is responsible for rapid increases in unemployment or under-employment.

In terms of legislation and fiscal policy, four bills were enacted in March and April of 2020. CBO estimates the total cost of these four packages at $2.3 trillion in additional spending and revenue losses, of which nearly $2.1 trillion will occur in 2020. Approximately 75% of these

costs are in the form of federal spending, mostly mandatory spending, and 25% of the cost impact represents revenue losses or tax rebates.

The first bill was devoted mostly to medical research spending to address the health issues. The second bill began the focus on economic relief, which remained the focus for the third and fourth bills. The second bill (known as Families First) devoted resources to programs such as nutrition assistance, Medicaid and Medicare, and tax credits for paid family and sick leave.

The third bill, known as the CARES Act, contained discretionary disaster response money but was primarily devoted to small (and larger) business relief in the form of loans, to unemployment benefits, and to tax relief known as Recovery Rebates for individuals below specified income levels. The fourth bill, known as the Paycheck Protection Act, funneled additional money into the small business loan program established in the CARES Act that provides incentives to employers to keep employees on their payrolls while at under stay-at-home orders, rather than moving them all onto unemployment insurance and Medicaid rolls.

On the monetary policy side, the Federal Reserve has taken a number of significant steps, including lowering the federal funds interest rate to zero, broadcasting its future plans more clearly ("forward guidance"), purchasing large quantities of federal and mortgage-backed securities ("quantitative easing"), reducing bank reserve requirements to zero, encouraging banks to use the Fed as their "lender of last resort", and reviving its emergency lending authorities for nonbank entities last used in the 2008 financial crisis to support, for example, the commercial and municipal bond markets.

The size of the total federal response is difficult to quantify, because the gross dollar amounts of liquidity the Federal Reserve has injected into the economy cannot be added to the $2.3 trillion cost of the four legislative packages in an apples-to-apples fashion. The large scope

of the federal response is driven simply by the size of the perceived problem we face.

Policymakers have struggled with how to respond to this unique crisis, most notably in balancing public health precautions that depress economic activity with the desire to limit such economic damage, and with making short-term vs. long-term tradeoffs. Even within the realm of economic responses, both the legislative and executive branches have floated ideas such as payroll tax cuts or infrastructure construction packages that are far better suited to a more traditional aggregate demand problem than they are to the current situation. Those approaches have been held in abeyance to date. And some needed new steps have been taken, most notably in providing unemployment assistance to workers in the so-called "gig economy."

CONCLUSION

The fiscal position of the federal system has been severely stressed since the end of the first quarter of 2020. Yet, even before the economic downturn due to COVID-19, the programs, procedures, and financial management systems within the government designed to ensure an efficient and effective process of service delivery and governance have been long overdue for reform. While the federal government as well as state and local governments are challenged to address the fiscal realities we face today, this Working Group offers many recommended changes for the short term and the long term that are designed to improve and enhance the contemporary system of public financial management.

The set of recommendations identified above are summarized below. We advise the next administration to increase focus on using scarce fiscal resources more effectively and efficiently. In particular, we recommend these actions:

- Create a 4-year strategic resourcing plan;
- Tighten the link between goals, priorities, and funding;

- Provide more emphasis on evidence-based policy choices;
- Increase engagement of line agencies & state and local governments;
- Implement accrual budgetary accounting for long-lived commitments; and
- Budget for infrastructure.

The Working Group also recognizes that the events of the last few months require a reexamination of governments' preparedness for emergencies. Budgeting explicitly for emergencies and for the long-term sustainability of governments at all levels of the federal system must be a priority. The strength of the democratic system requires a fundamentally sound and appropriately managed financial base. Improvements in effective, efficient, and equitable service delivery by federal, state, and local governments should be a high priority, and this Working Group's recommendations are offered as a way to strengthen governments' financial management systems.

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