

Portfolio Budgeting: A New Strategy for Budgeting
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For

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Chairman Enzi, Ranking Member Sanders and other Members of the Committee,

I want to thank you for inviting me to share my thoughts with you on Congressional budget reform. I commend the Committee for taking on the important but challenging project of federal budget reform.

In many respects, the high-minded goals of the 1974 Congressional Budget Act have been eclipsed by tenacious partisan polarization, a fragmented congressional committee structure and strong pressures from stakeholders to avoid tampering with existing priorities and programs. The federal budget process has become embroiled in polarized politics, at times barely able to keep the government open and financed. When it does achieve this very minimalist goal, it does little beyond providing an allowance for discretionary appropriations. And these ceilings have become increasingly symbolic statements rather than politically realistic targets to guide appropriations decisions. Budgeting has become less an arena to solve fiscal and policy problems together and more of a staging area where positions are taken for primary constituencies and other audiences far removed from running the government.

As a result, the current budget process does not enable Congress to achieve three important objectives: (1) set fiscal policy likely to keep the nation's economy on a sustainable course, both for today and the longer term; (2) allocate resources to assure that scarce resources are used to support the highest priorities; and (3)

ensure that government is equipped to deliver public services in the most efficient and effective way possible.

While much commentary has been devoted to the impact of the process on deficits and fiscal policy, the legitimacy of fiscal policy is critically dependent on the composition of spending and taxes that are used to reach fiscal targets. I will focus today on how the budget process affects the allocation of budgetary resources across the numerous claims that compete for scarce resources. . . Simply put, the budget process has failed to fulfill the expectations of the 1974 Act to become a vehicle to prompt a comprehensive review of priorities across federal programs and funding tools. Most of the federal budget is insulated from periodic reviews, as disproportionate attention is paid to the shrinking discretionary spending sector of the budget. The caps on discretionary spending in the budget resolution largely constitute symbolic targets rather than a real set of constraints – targets that often prove to be unenforceable without resorting to a set of increasingly pervasive gimmicks and sleights of hand.

Of course, there are many reasons much of the budget is not subject to periodic review and assessment. Mandatory spending and tax expenditures are, by design, protected from annual reviews in the interest of promoting certainty for beneficiaries and economic actors. Periodically reexamining these and other commitments entails difficult political choices for the Congress and the President alike, particularly in times when there is no surplus to celebrate. The Congress is

fragmented across its committees, which can be expected to resist the imposition of constraints or targets by the budget committees or even by the leadership if constraints require making hard choices among competing claims and constituencies. Nonetheless, the Congress itself has engaged in hard choices periodically, reforming welfare, social security and achieving budget surpluses in the 1990's. Should the deficit and other forces rear their head in a compelling way, Congress may wish to turn to a process that permits itself to more comprehensively rank and prioritize existing claims on the budget.

Much of the remainder of this statement considers whether and how the Congressional budget process can become a vehicle to prompt Congress to rationalize priorities based on a more comprehensive, strategic review of priorities and performance. Ideally, a budget process should be informed by evidence comparing the relative performance of related programs. As one former budget director stated, budgeting should concentrate on ferreting out weak claims, not weak claimants. As we face up to rising deficits in the years ahead, a performance assessment process may help lay the groundwork for making choices that not only resolve underlying fiscal deficits but also promote improved performance by reexamining existing program commitments. Ideally, such a process would consider the entire portfolio of federal programs and activities addressing a single policy goal or a set of related goals and outcomes. The portfolio would include mandatory and discretionary spending as well as tax expenditures – using a process we call portfolio budgeting.

Allocating scarce resources: the inescapable challenge for budgeting

Ideally, a budget process should facilitate informed tradeoffs among competing objectives, programs and tools of government. Former Congressman Charles Stenholm best described the competition that the congressional budget process was intended to inspire: “This process will require many tough choices as priorities are set among worthy programs. But essentially, all programs will be together in the same boat, competing for priority status as we seek to determine how best to allocate the revenues coming into the U.S. Treasury.”

I am concerned that the congressional budget process has strayed far from the vision of Mr. Stenholm and other guardians of the fiscal commons. The tradeoffs and hard choices that budgeting requires are far more difficult to achieve under our current political system than the one we had when the Congressional Budget Act was passed in 1974.

The current budget process is highly balkanized, with high walls separating programs in discretionary, mandatory and tax expenditure sectors. Related programs for such federal policies as higher education assistance or low-income housing are splintered across this fragmented budgetary landscape. While the budget resolution discusses the 19 budget functions that provide a mission oriented

framework integrating related programs across the budget, these potentially helpful categories are not, in fact, used to prompt appropriators or authorizers to consider how to allocate scarce resources across these competing functions.

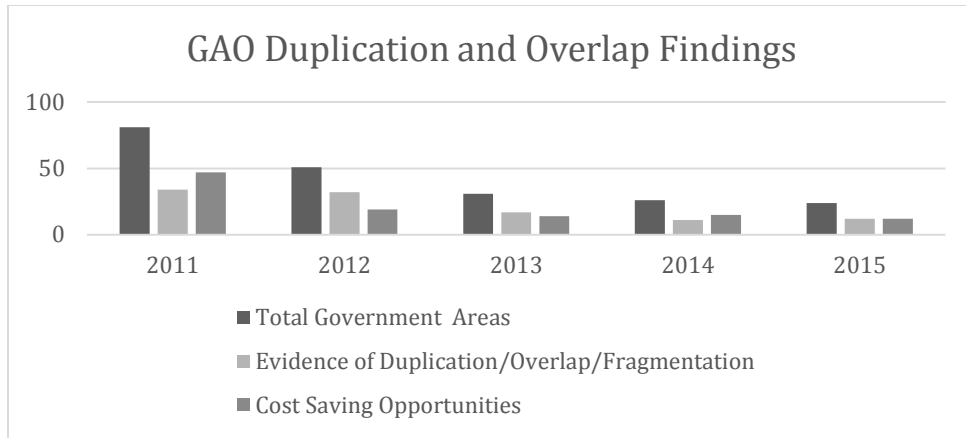
Discretionary spending bears the disproportionate impact of meeting fiscal targets and constraints, while existing tax and spending entitlements continue to drift upward with no regular review and little or no limits. Discretionary spending has declined from 9.3 percent of GDP when the Budget Act was passed in 1974 to less than 7 percent today, while mandatory programs have doubled during the same period to 13.5 percent of GDP. Tax expenditures, which function much like spending programs, are estimated at 8 percent of GDP, exceeding discretionary spending, and yet escape regular review. Deficit reduction plans can achieve greater savings in a more balanced way if they are applied against a broader base including spending and tax entitlements. While cutbacks are never easy, they are likely to be perceived as more fair if levied against all claims in the budget affecting all major stakeholders. Fiscal history tells us that stakeholders are not likely to accept the legitimacy of cuts if they are singled out, raising fears that their sacrifice will be exploited by champions of other budgetary claims.

As we think about priorities for using resources, it has become more apparent that the important goals and objectives of policy cut across the narrow confines of programs, budget accounts, bureaus, and congressional committees. For instance, nearly one half of the budget authority for homeland security is provided by

numerous agencies outside the Department of Homeland Security. Indeed, most of the major missions of government transcend the boundaries of the federal government itself, requiring partnerships with state and local governments, nonprofit organizations and for-profit firms.

The inventory of duplicative and overlapping programs compiled periodically by GAO is one reflection of rampant fragmentation across the federal landscape in programs addressing common goals.¹ Often the product of adaptive responses to emerging problems, the common response has been the proliferation of responsibilities and programs, perhaps targeted to a new clientele, or involving a new program delivery approach, or even simply merely layered onto existing systems and programs. GAO's five reports issued from 2011 through 2015 detail over 200 program areas with either significant fragmentation, overlap or duplication as well as other cost savings opportunities.

¹ Government Accountability Office, *2015 Annual Report: Additional Opportunities to Reduce Fragmentation, Overlap and Duplication and Achieve Other Financial Benefits*, GAO-15-404SP, April 2015



Profound institutional barriers to prevent easy tradeoffs between spending programs across different agencies and committees to address endemic program fragmentation. While the declining share of budgets devoted to discretionary spending are reviewed each year, periodic reviews of mandatory and tax expenditure programs are generally not encouraged. Tradeoffs between spending programs and tax expenditures are strongly discouraged, even though tax provisions and spending programs both address common purposes such as financing higher education, child care, job training, low income housing or research and development.² Split or shared ownership of these tools by different congressional committees and federal agencies constitutes the most significant barrier to their cross-cutting review in the budget process.

A focus on outcomes could support a cross cutting focus, because achieving most outcomes engages the resources of multiple programs, many agencies and

² U.S. Government Accountability Office, *Government Performance and Accountability: Tax Expenditures Represent a Substantial Federal Commitment and Need to Be Reexamined*, GAO-05-690, 2005.

nonfederal actors alike. The traditional unit of analysis in budgeting, however, is the budget account and the federal agency, with little opportunity to recognize the crosscutting dimensions of performance or to identify alternative strategies that would be a much more productive use of resources to drive achievement. For the most part, appropriated programs are reviewed in the annual process in an isolated way, typically with a focus on the marginal or incremental change in resources from one year to the next.

A Portfolio Approach to Reexamining the Base

A performance assessment process may help lay the groundwork for making budget choices that not only address macro fiscal goals but also promote more cost effective use of resources to achieve major policy goals. Such a process would consider the entire portfolio of federal programs and activities addressing a given goal, including mandatory and discretionary spending as well as tax expenditures. It would take advantage of the information on goals and performance Congress mandated be developed when it passed the 2010 Government Performance and Results Act Modernization Act, and take advantage of the Act's requirements for consultation with Congress when policy objectives are established.

The portfolio budget process I have in mind would assess the collective impacts of what are today fragmented initiatives and examine the likely benefits and costs of budget alternatives. The process would ask questions about the collective

performance of the portfolio of programs considered together. It would seek to identify:

- Which activities and programs constitute the portfolio and how much budgetary resources do they consume?
- Which current programs and policies are more cost-effective in achieving these goals?
- Which programs are considered to best achieve goals of fairness and equity in the distribution of benefits and costs?
- Which programs and policies are most critical in reinforcing the overall goals of the broad policy area and which undermine or work at cross purposes to those goals?
- Are there alternative ways of using limited resources that evidence suggests would be more productive than the current array of programs and policies in driving achievement of policy objectives?

Recognizing that such reviews are demanding both analytically and politically, they should be selectively deployed in the budget process. Far from zero based budgeting, portfolio budgeting should be used for areas where top officials have agreement that a deeper reexamination is most necessary.

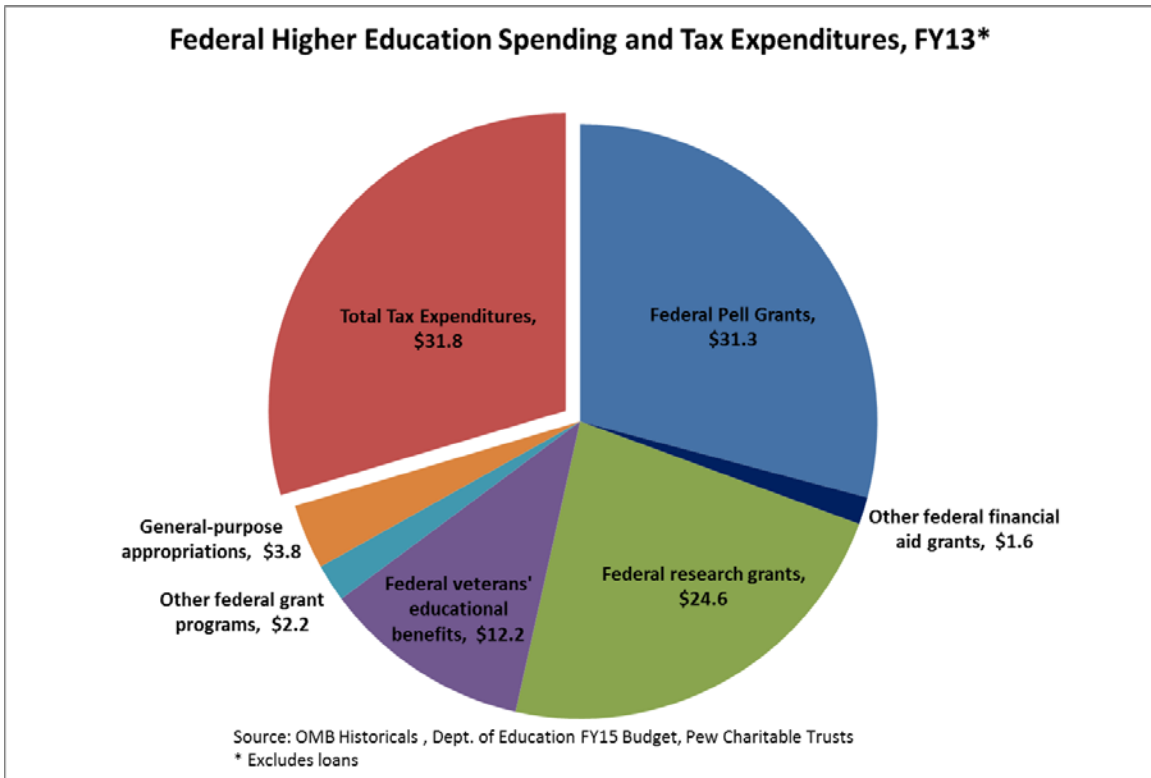
Most nations in the OECD now use a comprehensive spending review process to periodically consider selective broader policy areas in the budget process. Many

nations have learned from the Netherlands, which has been doing these reviews for at least twenty years. The 2010 spending review examined 20 topics and was designed to produce options to reduce spending by 20 percent over four years. So-called Interdepartmental Spending Reviews have been ongoing since the early 1980's, featuring a review of policy areas that cut across ministries. These initiatives have often included not only Finance and line ministry staff but also outside experts. They have led to significant savings over the years.³

For the National Budget Roundtable which I co-chair with Maya MacGuineas and Stuart Butler, my colleague, Steve Redburn, and I have developed a paper applying portfolio budgeting to policy objectives for federal aid to higher education.⁴ The federal budget provides an array of separate grant and loan programs and tax expenditures to help students pay for college, including special programs for veterans. The chart below shows the composition of federal activity - federal spending for higher education will exceed \$75 billion, slightly more than the States are expected to spend for their public higher education institutions, with an additional \$30 billion of tax expenditures provided through eleven discrete programs in the tax code. These figures do not include federal loans, which now have a total annual volume of \$700 billion, even though such programs turn a profit for the federal budget.

³ OECD, *Reallocation: The Role of Budget Institutions*, 2003.

⁴ Steve Redburn and Paul Posner, *Portfolio Budgeting: How a New Approach to Resource Allocation Could Yield Better Decisions*, National Budget Roundtable, Washington: Brookings, September, 2015.



While federal aid has grown, the myriad of subsidies has not been considered holistically, but rather has grown up in an ad hoc fashion, incubated in different congressional committees and federal agencies. It is ripe for review. In many ways, U.S. higher education is the envy of the world. At the same time, many questions have been raised about how effectively the current system of federal grants and loans is contributing to access by those who otherwise would not attend college and whether the increasing reliance on debt is reducing the personal economic returns that otherwise would accrue to those receiving federal support. Questions have been raised about whether federal subsidies are incentivizing states to reduce their own aid for students and inducing universities to raise tuition. Other questions revolve around whether the range of options and interactions among student loan

and grant programs make them hard to understand and challenging for students to calculate how best, when, and where to use them.⁵

Federal housing assistance offers another example of a major policy goal for which portfolio analysis could identify potential changes in strategy that would yield greater benefits and budget savings. GAO identified over 160 separate programs and activities assisting housing as shown in the following table.

GAO Analysis of Housing Programs

Primary purpose of activity ^a	Number of activities/programs	Agency/Entity																
		HUD	Treas/IRS	USDA	FHLB	VA	Regulators	NRC	FFIEC	CFPB	FCS	Fannie	Freddie	FarmerM	Interior	Labor	FHFA	FCA
Assistance for buying, selling, or financing a home	39	●	●	●	●													
Supports housing and other activities	30	●	●	●	●		●											
Assistance for financing rental housing	25	●	●	●	●													
Emergency assistance to housing market or current homeowner	16	●	●			● ^b												
Regulatory requirements	10	●				●		●	●									
Increase availability of mortgage loans	9	●	●		●					●	●	●	●					
Assistance for homeowners	9		●	●	●									●				
Assistance for rental property owners	8	●	●	●														
Rental assistance for tenants	6	●		●											●			
Operation/management of rental housing	6	●	●															
Regulator of government-sponsored enterprises	2															●	●	

CFPB = Consumer Financial Protection Bureau	Labor = Department of Labor
Fannie = Fannie Mae	NRC = Neighborhood Reinvestment Corporation
FarmerM = Federal Agricultural Mortgage Corporation (Farmer Mac)	Regulators = Financial federal regulators include the Federal Reserve, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and National Credit Union Administration
FCA = Farm Credit Administration	Treas/IRS = Treasury/ Internal Revenue Service
FCS = Farm Credit System	USDA = Department of Agriculture
FFIEC = Federal Financial Institutions Examination Council	VA = Department of Veterans Affairs
FHFA = Federal Housing Finance Agency	
FHLB = Federal Home Loan Banks	
Freddie = Freddie Mac	
HUD = Department of Housing and Urban Development	
Interior = Department of Interior/Bureau of Indian Affairs	

Source: GAO analysis of agency documentation.

Source: U.S. Government Accountability Office, *Housing Assistance: Opportunities Exist to Increase Collaboration and Consider Consolidation*, August, 2012, GAO-12-554

⁵ U.S. Government Accountability Office, *Student Aid and Postsecondary Tax Preferences: Limited Research Exists on Effectiveness of Tools to Assist Students and Families Through Title IV and Tax Preferences* GAO-05-684, July, 2005

A specific focus on low income housing raises provocative questions with budgetary and performance implications. The budget includes about \$50 billion a year in various forms of low-income housing assistance. In 2014, this included \$37 billion in HUD subsidies to aid over 5 million low-income households (about 10 million people) – including residents of public housing and privately owned subsidized projects, and those renting private units with portable housing vouchers. Federal expenditures also included revenues losses for the Low-income Housing Tax Credit (LIHTC) used by States to develop new low-income housing projects, reducing federal revenues by \$ 7 billion in 2014. (It should be noted that these numbers are dwarfed by the over tax expenditures for homeownership, which reduced income tax revenues by \$130 billion in 2014.)

A portfolio analysis could consider the relative cost-effectiveness of these programs – and others administered by the Department of Agriculture and for homeless veterans by the Department of Veterans Affairs – used separately and in combination. Together, they constitute the current implicit federal strategy to improve housing and neighborhood conditions for low-income families and the elderly. They also, it should be noted, are part of a much broader set of programs to improve the lives and economic self-sufficiency of low-income people. Many questions have been raised about the best form and use of federal housing assistance, and new research suggests a potential for large gains by poor children if

their families use portable housing vouchers to relocate to neighborhoods where they can find better schools, greater safety, and better access to jobs.

Questions also could be asked about the best use of federal expenditures: for example, is it more cost-effective to subsidize construction of new projects, which in some places compete with older unsubsidized low-rent units and contribute to their abandonment, or to provide portable subsidies that allow more choice of housing type and location? Another set of questions concerns the characteristics and circumstances of those most likely to benefit from assistance: who should receive priority, and what other forms of assistance might enable them to get more benefit from a housing subsidy? A broader look at federal support for housing might ask whether, given the government's priorities and limited resources, support for homeownership – which mostly benefits more affluent people – could be reduced and the budget savings used to aid more modest-income households, whether renting or buying a first home.

These examples illustrate how a portfolio budgeting review may yield approaches to use limited resources more productively and to reduce fragmentation, overlap and duplication. Such options may include improved interagency coordination and strategic planning on the administrative side or program consolidation and redesign on the policy side. In some cases, such a review may conclude that fragmentation, on balance provides positive benefits by promoting increased choices to program beneficiaries and state and local governments.

While prompted by fiscal necessity, such deeper strategic reviews of the portfolio of major programs and policies for selected policy areas can serve the vital function of updating the federal government's programs and priorities. Many programs were, in fact, designed many years ago to respond to earlier concerns and priorities. We are reminded how much has changed in the past several decades from emerging shifts in security threats, globalization of economic transactions, changing environmental concerns, significant technological advances and aging populations. As the GAO said in a 2005 report, as we face continuing chronic and structural deficits, reexamining existing spending and tax programs may be the key to freeing up resources to address emerging needs. ⁶

Where Do We Go From Here?

There are many pathways through which portfolio budgeting may take root in the budget process. The selection of areas for review and performance improvements could be accomplished in the Congress either by the leadership, in consultation with the President, or by this Committee as a part of the congressional budget process. The existing budget functions and subfunctions could be used as a basis for determining crosscutting policy areas, as intended when they were folded into the congressional budget process.

⁶ U.S. Government Accountability Office, *21st Century Challenges: Reexamining the Base of the Federal Government*, March, 2005, GAO-05-325SP

The budget committees can take the lead in fostering broad based portfolio reviews of major functions or subfunctions. They can do this on their own through task forces, similar to performance based reviews done by task forces of the Senate Budget Committee in the early 2000's. The Budget Committee also can do this by working collaboratively with authorizing and appropriations committees, commissioning portfolio reviews in concert with those committees.

Portfolio reviews can best serve the budget process if they were guided by a fiscal savings target. Such targets would ensure that the results would be used in budget formulation and help provide needed discipline to the selection of portfolio strategies and alternatives. Such reviews can be triggered by what we might call performance based reconciliation instructions where task forces or committees expected to report savings to be integrated by the budget committees into a reconciliation bill

The Executive Branch could be engaged in a collaborative effort to undertake a series of selective portfolio reviews. The President and Congress could reach agreement about those areas to be assessed in each budget year. Congress could advise the Administration that areas that are ripe for reexamination, such as those up for reauthorization, should get attention in the executive review process. Such a process would require the Congress to articulate its oversight and reexamination priorities centrally and the President to invite Congress to help determine priorities to guide the executive's own budget review process.

I don't need to tell this Committee that the performance assessment process I am suggesting will not be easy. There are no low hanging fruit in the federal budget. In fact, performance based assessments of the base of groups of programs will entail the prospect of greater conflict. This new role will require the Committee to gain the support of other leaders in the Congress as well as the Administration. It will be important for this process to be highly selective in its reviews, to avoid being overwhelmed by the sheer amount of work as well as the likely political reaction. Nonetheless, the potential rewards are substantial. Performance assessments carry the promise of transforming the budget process into a more strategic and forward looking vehicle for setting the nation's priorities.

Notwithstanding the challenges associated with reexamination, reviewing the base of programs and operations has ample precedent. The federal government, in fact, has reexamined and reformed selected programs and priorities in the past. From a programmatic perspective, such reexaminations have included, for example, the 1983 Social Security reform, the 1986 tax reform, and the 1996 welfare reform. They have also included reforms such as the creation of the Department of Homeland Security and, most recently, the ongoing reorganization of the U.S. intelligence community. From a broader fiscal standpoint, the 1990s featured significant deficit reduction measures adopted by the Congress and supported by the President that made important changes to discretionary spending, entitlement program growth, and revenues that helped eliminate deficits and bring about

budgetary surpluses. Roy Meyers indeed argues that budget reform is not necessarily an impossible political project, and shows examples such as earmark reform that seemed to defy the prevailing cynicism about Congressional resistance to new budget practices and institutions.⁷

Given CBO and GAO projections of unsustainable debt in years to come, Congress and the President will be called on to reach agreements to make hard choices to reduce spending and/or increase revenues. The question is whether such inevitable choices will be made through the regular process, supported by careful analysis and deliberation, using a method like portfolio budgeting, or whether they will be forged outside the regular order in the heat of a fiscal or economic crisis. I think we would all prefer the former.

Conclusion: Transforming the Budget Committees

Budget process reforms present risks and opportunities for the Congress and this Committee. The ideas for budget process reform I have laid out would place new demands on the federal budget process in general and this Committee in particular. I am well aware that these emerging roles are even more challenging for a Congress that has trouble simply passing a budget resolution and securing a full year's appropriations for the agencies. Yet the fiscal challenges and the need to update our

⁷ Roy Meyers, *The Political Feasibility of Doing What is Almost Impossible: Reforming the Federal Budget Process*, Working Paper for the National Budget Roundtable, George Mason University, September, 2015

priorities both call for major new activities that can best be performed by the Budget Committees.

Strengthening Congress' capacity to budget will call for stronger leadership within the Congress and from the President as well. This Committee will be challenged to assert a more proactive role in setting priorities, reviewing government performance and shifting how we budget for the long term. This is a tall order, particularly during today's period of polarized politics.

It may be time to rethink the nature of the budget committees. Established in 1974 as new committees alongside an established committee structure, the budget committees have increasingly been tasked to take on government-wide leadership without enough influence over other committees to do the job. Accordingly, some have suggested that budget committees be transformed into leadership committees, comprised of the chairs of the major committees of each house.⁸

An old adage in management suggests that form should follow function. The original design of the 1974 Budget Act contemplated a less ambitious role for the budget committees. Powerful committees were at hand to trim their sails. Yet over time, the budget process has had to adapt to serve new functions: reconciliation, new scoring rules implementing new budget legislation, and greater demand for complex

⁸ Philip G. Joyce, "Strengthening the Budget Committees: Institutional Reforms to Promote Fiscally Responsible Budgeting in Congress", paper prepared for the Federal Budget Reform Initiative, Pew Charitable Trusts, January, 2011.

analysis of long term and dynamic economic effects of proposed legislation have all changed the scope and stakes of the congressional budget process. The Budget Committees are at a threshold moment and need to adapt to meet the emerging needs of the Congress and the nation for a revitalized budget process.