

The Illinois Budget Policy TOOLBOX



Tools to Address Spending

Across the Board Cuts

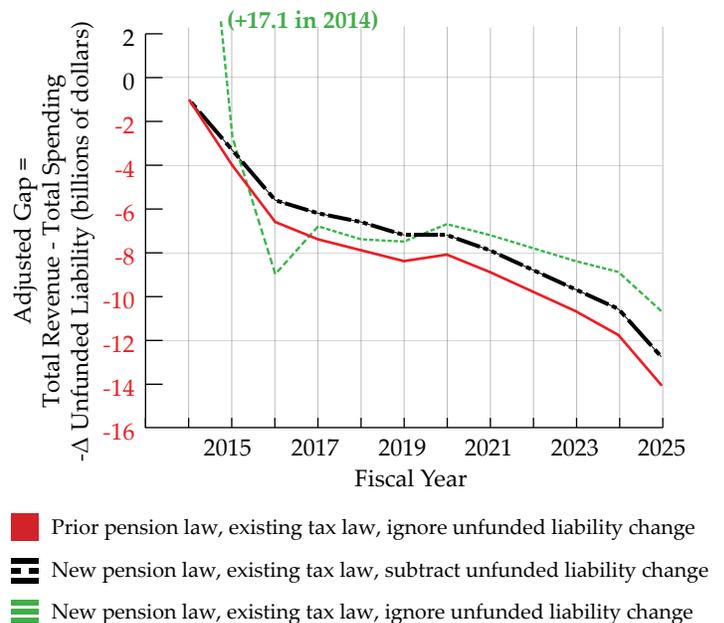
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As the introductory reports in the Policy Toolbox demonstrate, projected state spending in Illinois outpaces projected revenue for the next several years, with the gap increasing over time. As Figure 1 shows, IGPA’s Fiscal Futures Project has found that from 2015 onward, the deficit will rise from around \$4 billion per year to over \$12 billion per year in 2025, even under an optimistic pension reform scenario.¹

This unsustainable state of affairs can be addressed by increasing revenue and/or decreasing spending. The projected deficit could even be helped by allowing spending to grow – just at a slower rate than currently expected (what we call “bending the curve”), or by substantial economic growth in the state. Other reports in the Budget Policy Toolbox discuss various approaches to increasing revenue. This report will focus on one strategy to cut expenditures.

Any discussion of increasing revenue typically moves quickly to the specific revenue instruments and rates. But cutting government spending is often discussed in very general terms, at least in political debate

Figure 1: Illinois All-Funds Structural Budget Gap Projections, 2014-2025



and the news media. Government spending is large, diverse, and amorphous. As such, it is difficult for policymakers—much less the general public—to understand it in depth.

When discussing the budget, people often speak broadly about “the need to cut government spending.” Indeed, most Americans are *opposed* to government spending in general, since it is paid for by taxes, which

¹Dye, Richard, Hudspeth, Nancy and Merriman, David. (2014). Illinois still has serious fiscal problems after December 2013 pension law changes. Available at: <http://igpa.uillinois.edu/system/files/Pension-Reform-Will-Not-Fix-Deficit.pdf>

no one likes. Government spending in the abstract may seem to offer no benefit to them. Of course, when broken down into specific cuts of specific goods and services provided to people and business, the identification of clear losers makes budget cutting much more controversial. In other reports of this Budget Policy Toolbox, we examine some of the areas where state government spends the most—education, human services, health care—to evaluate specific approaches to budget cuts that have currency in public policy discussion in Illinois and elsewhere. But in this report, I consider the most general strategy for budget cutting that is typically on the political agenda: **across-the-board (ATB) cuts**.

In their purest form, ATB cuts reduce government spending by a certain percentage in every department, agency, or program. So to get a 5 percent overall reduction in government spending, the idea is to reduce spending in every department, agency, or program by 5 percent. A recent highly visible example of this approach is found in the federal Budget Control Act of 2011 (BCA). The BCA used the specter of ATB cuts in federal spending in an attempt to coerce Congress and the president to pass significant targeted cuts. But these targeted cuts were not made by the BCA's deadline of January 1, 2013, so ATB cuts were implemented in federal spending of between 8.5 percent and 10 percent in most programs, commonly referred to as the federal "sequester."

Across-the-board cut considerations

The federal sequester is not a pure ATB cut, but it is as close to one as is usual in practice. Indeed, the ways that the federal sequester deviates from a pure ATB cut highlight important considerations for any proposal that moves in the direction of this approach:

1.) Rate of cuts: Policymakers must decide the level of spending reduction, as determined by the overall savings needed. Decisions also must be made about whether all spending should be cut by the same percentage (a true ATB cut), or whether some types or areas of spending should be cut less than others. For example, the federal sequester reduces some spending by 10.0 percent, some by 2.0 percent, and some not at all in 2013. It also varies the rates of reduction over time.

2.) Exemptions from cuts: Spending for certain types of public services may be exempted entirely from ATB cuts. For example, interest on general obligation bonds and pension obligations are typically exempted from ATB cuts, since cuts in these would violate contracts

and have serious financial and legal implications. Federally mandated spending or spending that receives considerable federal matching may also be exempted from state budget ATB cuts. Some spending may be exempted from ATB cuts for programmatic reasons, such as the BCA exempting veterans' health programs and Pell Grants from sequester. However, the more spending that is exempted, the deeper the cuts will be elsewhere to generate a given rate of overall spending reduction.

3.) The organizational level at which the ATB cuts apply: Roughly speaking, a decision has to be made about whether ATB cuts will be made at the departmental, agency, or programmatic level. For example, a given percentage of spending reduction could be recouped from the Department of Transportation generally, or from the Division of Highways specifically, or even to the detail of the expansion of U.S. Highway 67 between Alton and the Quad Cities. The higher the level at which cuts are mandated, the more flexibility policymakers have to alleviate some of the drawbacks of ATB cuts discussed below. The federal sequester requires cuts be aggregated only at the detailed activity level, allowing very little flexibility.

4.) Cutting current spending or limiting increases in spending: The discussion of government spending is often couched in terms of limiting increases in spending rather than in cutting current levels. As population grows, more government spending is typically needed just to keep a consistent level of service.

Pros of ATB cuts:

- Simple—ATB cuts appear to be simple, and they can be discussed as such in the course of political campaigns. The message of "a 5 percent across-the-board spending cut" is easy to communicate in a campaign ad or political debate.

- Fair—ATB cuts have the appearance of fairness. "Everyone is taking the same hit." Again, this message is especially useful in political campaigns where the idea of fairness is quite positive. The apparent simplicity of this fairness message allows it to be communicated to a mass audience concisely.

- Hides the pain of cuts—Advocating ATB cuts keeps the discussion of cuts at the general level of "government spending," thus diverting attention from the pain inflicted by a reduction in public goods and services to which such cuts would lead. Americans typically support reduced government spending. When those cuts are linked to reducing specific services that they enjoy, public support is much lower.

- Forces tough cuts—Government spending is difficult to cut because of the specific benefits that various businesses and people in society gain from it. Since ATB cuts keep the debate at a general level and do not identify cuts to specific programs, they can help generate sufficient public support to overcome political opposition.

Cons of ATB cuts:

- Missed opportunity to cut ineffective programs—ATB cuts do not discriminate on the basis of the effectiveness or quality of a government service or good. By definition, all programs are kept in place but just reduced in size and scope. If some public goods and services are delivered poorly, a round of selective budget-cutting may provide an opportunity to eliminate them. With selective cuts, Illinois' current budget crisis may provide an opportunity to eliminate bad programs. As Chicago Mayor Rahm Emanuel said when he was President Obama's chief of staff, a "crisis provides the opportunity ... to do things that you could not do before."²

- Unequal policy priorities—ATB cuts not only ignore differential effectiveness between government programs, they also ignore differences in policy priorities. That is, ATB cuts are agnostic as to what the government really ought to be doing. Put another way, ATB cuts lock in the status quo policy priorities. Changes in priorities are ignored, as are considerations about whether a minimum level of service is needed in a given area. ATB cuts may reduce spending for a service below a minimum necessary level, while leaving other less-vital services funded above their minimum level.

- "Lumpy" programs—Certain public goods and services are "lumpy." That is, they come in discrete packages that are not amenable to reduction by a small percentage. For example, cutting 5 percent off the length of a proposed highway bridge may not be feasible. Related to the previous point, the lumpiness of a public program may derive from being worthless or unacceptable at less than some minimum level of spending. For example, a university's law school may need a certain number of specifically qualified faculty to gain the accreditation it needs to be viable.

- Economies of scale—Economies of scale in government service may be threatened by ATB cuts. In particular, administration and back-office services may actually cost more per unit of output after ATB cuts. For example, if every agency is required to cut spending 5 percent, while retaining a director, a human resources

department, and other administrative functions, then that agency is getting less programmatic output per dollar spent (unless the director's salary and human services personnel salaries are cut 5 percent, which is unlikely due to both the difficulty of reducing individuals' salaries and the lumpiness of certain administrative functions).

- Consumption vs. investment—A given year's budget includes some spending that is for current beneficiaries and other spending that is an investment in the future. Current spending on construction of highways and other infrastructure that could last for 50 years or more may help increase future labor force productivity and workers' earnings—and their future income taxes paid to the state. An across-the-board spending cut that applies to the most productive public investments may reduce current budget spending while making future budget problems worse.

The organizational level at which ATB cuts are applied has a large effect on the actual impact of these drawbacks. At the program level, policymakers may not be able to eliminate ineffective programs, and such programs may be too lumpy to reduce by a small percentage. But if the same percentage of ATB cuts was applied at the departmental level, then policymakers within each department might be able to move funds from ineffective to effective programs and to overcome lumpiness issues. Likewise, consolidating administrative functions across programs within a department may mitigate the harm of ATB cuts on economies of scale.

Conclusion

Across-the-board budget cuts can be useful as political rhetoric but have significant difficulties of implementation. To mitigate these implementation problems, policymakers can:

- Require cuts at the department or agency level—rather than the program level—for greater flexibility
- Allow for differential percentage cuts among the different departments or agencies based on a current assessment of policy priorities and the impact of reduced government spending on those priorities.

But, of course, these sorts of modifications move any such budget reduction away from a pure ATB cut to a plan based on the priorities and resources of the state. In other words, these modifications move in the direction of the normal budget-making process. •

²Seib, Gerald F. (2008, November 21). In crisis, opportunity for Obama. *The Wall Street Journal*. Available at <http://online.wsj.com/news/articles/SB122721278056345271>

Further Reading

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