BALANCING THE FEDERAL BUDGET AND LIMITING FEDERAL SPENDING: CONSTITUTIONAL AND STATUTORY APPROACHES

The Congress of the United States
Congressional Budget Office

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402

PREFACE

The Congress is considering over a hundred proposals that would limit the growth of federal spending or revenues, prohibit federal budget deficits, or both. Some of the proposals are in the form of amendments to the U.S. Constitution while others are in the form of legislation. One of these, S.J. Res. 58, has already passed the U.S. Senate. All of the proposals presume that the current budgetary procedures are incapable of overcoming a perceived bias in favor of ever greater levels of federal expenditures and persistent deficits.

This study, prepared at the request of the Senate Committee on the Budget and the House Committee on the Judiciary, analyzes the present system and the alternatives before the Congress. The study examines the degree to which the current procedures have produced ever higher levels of expenditures and persistent deficits, describes the rationales of the present system and the proposed alternatives, analyzes the effects of the alternatives on the economy and the size of the federal sector, and sets out some of the major difficulties that might be encountered in implementing the alternatives. In keeping with the mandate of the Congressional Budget Office (CBO) to provide objective analysis, the report contains no recommendations.

The paper was written primarily by John W. Ellwood. Alfred B. Fitt wrote Chapter I; Robert W. Hartman wrote the section on "The Short-Run Effects" in Chapter V; and Marvin M. Phaup, Jr., wrote the section on "The Long-Run Effects" in Chapter V. The authors wish to thank James Annable, William Beeman, James Blum, James Capra, Martin Levine, John Shillingburg, Paul Van de Water, and James Verdier of CBO for their comments. In addition, many persons outside CBO provided valuable advice and criticisms, including Mickey Levy, William A. Niskanen, Donald G. Oglivie, Allen Schick, and Aaron Wildavsky.

Patricia H. Johnston edited the manuscript. Nancy H. Brooks typed the paper and prepared it for publication; Norma Leake typed several early drafts.

Alice M. Rivlin
Director

September 1982

CONTENTS

		Page
PREFACE	. . . .	iii
S.J. RES. 58	. . . .	xiv
CHAPTER I.	INTRODUCTION AND OVERVIEW	1
	Overview	1
	Plan of This Paper	8
CHAPTER II.	THE HISTORICAL RECORD	9
	The Unbalanced Budget	9
	The Size of Government and the Growth of Spending	16
	Patterns of Expenditure Growth	22
	Public Attitudes Toward Federal Spending and Deficits	28
	Why Now?.	30
CHAPTER III.	OPTIONS FOR ACHIEVING ANNUALLY BALANCED BUDGETS AND LIMITATIONS ON EXPENDITURE AND REVENUE GROWTH, SHORT OF STATUTORY OR CONSTITUTIONAL REQUIREMENTS	33
	Current Policy.	34
	Proposals to Provide More Information and Visibility	37
	Increase the Authority and Influence of Those Representatives and Institutions Most Likely to Limit Federal Spending or Balance the Budget	48
CHAPTER IV.	LEGISLATIVE AND CONSTITUTIONAL OPTIONS THAT WOULD REQUIRE BALANCED BUDGETS OR LIMIT EXPENDITURE GROWTH.	53
	The Problem: System Bias in Favor of Increased Expenditures and Deficits	53

CONTENTS (continued)

		Page
	Options Requiring a Balanced Budget	59
	Options for Limiting Expenditure and Revenue Growth	63
	H.J. Res. 350 and S.J. Res. 58: Combining Deficit Restrictions and Expenditure and Revenue Limitations	68
CHAPTER V.	THE EFFECTS OF ANNUALLY BALANCED BUDGETS ON THE ECONOMY AND THE SIZE OF THE FEDERAL SECTOR	73
	Short-Run Effects on the Economy and the Federal Sector	73
	Long-Run Effects on the Economy	78
CHAPTER VI.	THE EFFECTS OF EXPENDITURE LIMITATIONS ON THE ECONOMY AND THE SIZE OF THE FEDERAL SECTOR	89
	Effects on the Economy.	89
	Effects on the Size of the Federal Sector	90
CHAPTER VII.	DIFFICULTIES OF ENFORCING A PROHIBITION	103
	Problems of Enforcement	104
	Avoiding an Expenditure Limitation	110
	Loss of Congressional Authority	112
APPENDIX A.	LESSONS FROM STATE EXPERIENCE	117

TABLES

		Page
TABLE 1.	CENTRAL GOVERNMENT NET LENDING ON A SYSTEM OF NATIONAL ACCOUNTS BASIS AS A PERCENT OF GDP/GNP	11
TABLE 2.	FEDERAL OUTLAYS AS A PERCENTAGE OF GROSS NATIONAL PRODUCT, FISCAL YEARS 1956-1981	18
TABLE 3.	PERCENTAGES FAVORING OR OPPOSING A BALANCED BUDGET AMENDMENT AND VARIOUS POTENTIAL SPENDING REDUCTIONS IN JANUARY 1979	29
TABLE 4.	NEW COMMITMENTS FOR FEDERAL CREDIT ACTIVITIES	44
TABLE 5.	PROJECTED FEDERAL DEFICITS	74
TABLE 6.	COMPOSITION OF FEDERAL OUTLAYS	77
TABLE 7.	FEDERAL BUDGET DEFICITS AND UNEMPLOYMENT AND INFLATION RATES (ACTUAL AND SIMULATED), FISCAL YEARS 1966-1969	81
TABLE 8.	FEDERAL BUDGET DEFICITS AND UNEMPLOYMENT AND INFLATION RATES (ACTUAL AND SIMULATED), FISCAL YEARS 1970-1972	83
TABLE 9.	UNEMPLOYMENT AND INFLATION RATES (ACTUAL AND SIMULATED), CALENDAR YEARS 1974-1977.	84
TABLE 10.	CBO'S OPTIMISTIC AND PESSIMISTIC ASSUMPTIONS	95

TABLES (continued)

Page

TABLE 11. REDUCTION IN UNIFIED BUDGET RESULTING FROM HYPOTHETICAL FISCAL YEAR 1978 FEDERAL CAPITAL BUDGET FOLLOWING THE BUDGETARY PROCEDURES OF FOUR STATES 109

APPENDIX TABLES

TABLE A-1. SUMMARY OF LIMITATIONS ON STATE DEFICITS 118

TABLE A-2. CONVERTING SAMPLE STATE BUDGETS TO THE FEDERAL FORMAT: SUMMARY OF ADJUSTMENTS 119

TABLE A-3. LONG-TERM INDEBTEDNESS OF STATE GOVERNMENTS, JUNE 30, 1977 122

TABLE A-4. STATE AGENCIES AUTHORIZED TO ISSUE NONGUARANTEED OBLIGATIONS 127

TABLE A-5. PERCENTAGE DISTRIBUTION, GROSS PUBLIC DEBT 128

FIGURES

		Page
FIGURE 1.	FIVE-YEAR MOVING AVERAGE OF THE UNIFIED BUDGET SURPLUS OR DEFICIT AS A PERCENT OF GNP	10
FIGURE 2.	SELECTED GENERAL GOVERNMENT NET BORROWING AS A PERCENT OF GNP/GDP ON A SYSTEM OF NATIONAL ACCOUNTS BASIS, 1970-1982	14
FIGURE 3.	COMPARISON OF GENERAL GOVERNMENT DEFICITS AND REAL GDP GROWTH, 1970-1980	15
FIGURE 4.	COMPARISON OF GENERAL GOVERNMENT DEFICITS AND CONSUMER PRICE INFLATION, 1970-1980	15
FIGURE 5.	EVOLUTION OF GENERAL GOVERNMENT EXPENDITURE, 1960-1980	20
FIGURE 6.	COMPARISON OF THE SIZE OF THE GENERAL GOVERNMENT SECTOR AND REAL GDP GROWTH, 1970-1980	21
FIGURE 7.	COMPARISON OF THE SIZE OF THE GENERAL GOVERNMENT SECTOR AND CONSUMER PRICE INFLATION, 1970-1980	21
FIGURE 8.	UNIFIED BUDGET OUTLAYS AS A PERCENT OF GNP, BY TYPE OF OUTLAY	24
FIGURE 9.	FIVE-YEAR MOVING AVERAGE OF ACTUAL OUTLAYS, ACTUAL REVENUES, AND S.J. RES. 58/H.J. RES. 350 REVENUE AND OUTLAY LIMITS AS A PERCENT OF FISCAL YEAR GNP, ASSUMING IMPLEMENTATION OF S.J. RES. 58/H.J. RES. 350 IN FISCAL YEAR 1981	101

S.J. RES. 58
AMENDMENT TO THE CONSTITUTION
As proposed by the U.S. Senate on
August 4, 1982

Article --

SECTION 1. Prior to each fiscal year, the Congress shall adopt a statement of receipts and outlays for that year in which total outlays are no greater than total receipts. The Congress may amend such statement provided revised outlays are no greater than revised receipts. Whenever three-fifths of the whole number of both Houses shall deem it necessary, Congress in such statement may provide for a specific excess of outlays over receipts by a vote directed solely to that subject. The Congress and the President shall, pursuant to legislation or through exercise of their powers under the first and second articles, ensure that actual outlays do not exceed the outlays set forth in such statement.

SECTION 2. Total receipts for any fiscal year set forth in the statement adopted pursuant to this article shall not increase by a rate greater than the rate of increase in national income in the year or years ending not less than six months nor more than twelve months before such fiscal year, unless a majority of the whole number of both Houses of Congress shall have passed a bill directed solely to approving specific additional receipts and such bill has become law.

SECTION 3. The Congress may waive the provisions of this article for any fiscal year in which a declaration of war is in effect.

SECTION 4. Total receipts shall include all receipts of the United States except those derived from borrowing and total outlays shall include all outlays of the United States except those for repayment of debt principal.

SECTION 5. The Congress shall enforce and implement this article by appropriate legislation.

SECTION 6. On and after the date this article takes effect, the amount of Federal public debt limit as of such date shall become permanent and there shall be no increase in such amount unless three-fifths of the whole number of both Houses of Congress shall have passed a bill approving such increase and such bill has become law.

SECTION 7. This article shall take effect for the second fiscal year beginning after its ratification.

CHAPTER I. INTRODUCTION AND OVERVIEW

Persistent federal deficits, coupled with steady growth in the share of the economy devoted to federal spending, have caused concern in many quarters. This concern led 31 state legislatures to petition the Congress to take some kind of action that would result in a Constitutional amendment favoring balanced budgets. More than 100 measures have been introduced in the 97th Congress proposing either statutory or Constitutional changes aimed at making deficits less likely and spending and taxing restraint more likely. President Reagan has endorsed and the Senate of the United States has now passed a resolution proposing a specific Constitutional amendment on the subject.

This report begins with an overview of the Senate proposed amendment and the mid-1980s budget context in which it might take effect. Chapter I concludes with a description of the organization of the balance of the report.

OVERVIEW

When introduced in 1981, Senate Joint Resolution 58 and House Joint Resolution 350 were identical proposals for amending the Constitution to prescribe certain Congressional budget-making rules. The Senate, on August 4, 1982, by a 69-31 margin approved an altered version of S.J. Res. 58, while the House Committee on the Judiciary still is considering H.J. Res. 350. This overview will describe only S.J. Res. 58, because it remains to be seen whether or in what form the House will take up the question.

Provisions of S.J. Res. 58

The proposed amendment is designed to accomplish two purposes: to encourage the adoption of balanced instead of deficit budgets, and to limit the size of the federal government as a proportion of the total economy.

Balancing the Budget. S.J. Res. 58 directs the Congress, before the start of each fiscal year, to "adopt a statement of receipts and outlays for that year in which total outlays are no greater than total receipts."

If the amendment is ratified, the Constitution thereafter would consider balanced budgets to be the normal rule. Departures from that rule would be permitted, however, since the "statement of receipts and outlays"--that is, the budget of the United States government--may project outlays greater than receipts if three-fifths of the whole membership in both bodies approve.

Limiting the Size of Government. The proposal prohibits projecting receipts to rise at "a rate greater than the rate of increase in the national income," unless an absolute majority in both bodies has passed a bill "approving specific additional receipts and such bill has become law."

Because the normal rule set forth by S.J. Res. 58 is that outlays will not exceed receipts, and because receipts may not grow more rapidly than national income, the effect is to place an upper bound on federal spending as a proportion of national income. However much or little the national income grew in the base period (which the amendment leaves for later Congressional definition) will determine however much or little federal spending can be projected to grow in the budget year, irrespective of the assumed performance of the economy in that budget year.

The short-run effect of this formulation is to discourage balancing the budget by raising taxes instead of cutting spending. The long-run effect is to prevent growth of the federal government in relation to the private sector, unless Congressional majorities specifically vote otherwise.

This portion of the amendment is apparently mainly aimed at the "unlegislated" tax increases resulting from the effect of inflation on a progressive income tax system: taxpayers whose real incomes are not increasing are nevertheless pushed into higher income tax brackets and therefore pay a larger share of their incomes to the federal Treasury ("bracket creep"). If the Congress must vote the increase instead of simply letting it happen, an increase is less likely. (Another approach, but one with the same effect and already adopted by the Congress for 1985 and future years, is to index income tax brackets and exemptions to inflation in ways that will minimize bracket creep.)

Enforcement. The proposed amendment is not self-enforcing. No penalty is prescribed if the Congress is unable or chooses not to adopt a budget. In those circumstances, the "budget" would be the sum of appropriation and revenue bills that became law for that year, whether a surplus, a balance, or a deficit.

Section 5 of the proposal commands the Congress to "enforce and implement this article by appropriate legislation," however. The command is very clear, but in the end the response must be shaped by the Congress; it would not be found in the Constitution.

Assuming that the Congress does adopt "a statement of receipts and outlays," then the proposed amendment directs both the Congress and the President to "ensure that actual outlays do not exceed the outlays set forth in such statement." The precise means for ensuring such an outcome are left for later legislative prescription or, in the case of the President, through the exercise of whatever Constitutional powers he already possesses.

Actual revenues, on the other hand, need not agree with the receipts projected in the budget; they may be either more or less. Thus, while the amendment does not tolerate an excess of actual outlays over planned outlays (even if the budget still remains in balance), it accepts a level of actual revenues short of planned receipts (even if this results in a deficit).

The reason for more lenient treatment of revenue shortfalls than outlay overruns was that the drafters of the amendment wished to allow for a short, unexpected recession, and its consequent revenue loss, without necessitating immediate compensating tax increases or spending cuts that might worsen the recession. However, a section added on the Senate floor erects the barrier of a supermajority vote against unplanned as well as planned deficits.

The Armstrong-Boren Amendment. During debate on S.J. Res. 58, Senators Armstrong and Boren successfully cosponsored what is now Section 6 of the proposed amendment. The section prohibits any increase in the statutory public debt ceiling on the date the amendment takes effect, unless three-fifths of the whole membership of both bodies thereafter approves a bill for that purpose and the bill becomes law.

The effect of Section 6 is to impose a real sanction against evading the strictures of the proposed amendment by simply failing to adopt any budget at all. But Section 6 would also bar unplanned deficits resulting from revenue shortfalls, unless there was leeway within the statutory debt ceiling. (This is true under present law as well, but simple majorities in the Congress, with the concurrence of the President, can raise the debt ceiling as necessary, whereas under Section 6, just 41 percent in either body could prevent a solution.)

98-379 O - 82 - 2

Waiver and the President. All the provisions of the proposed amendment may, but need not, be waived by simple majorities in the Congress for any fiscal year in which a declaration of war is in effect.

The President has no formal role either in the declaration of a war or in the waiver permitted by the amendment. Similarly, he has no formal role in the process by which Congress would adopt or amend "a statement of receipts and outlays" under S.J. Res. 58, whether in balance or in deficit. But he would have a role if the Congress wished to project receipts greater than permitted by the amendment's formula, for that would require a bill to be presented for his approval.

Effective Date. The amendment provides that it "shall take effect for the second fiscal year beginning after its ratification." For example, if the necessary number of states were to ratify the amendment before October 1, 1983, it would apply to fiscal year 1985, and the first "statement of receipts and outlays" would have to be in place by September 30, 1984, that is, sometime during the first fiscal year beginning after ratification.

The Purposes of S.J. Res. 58: Are They Desirable?

The First Goal: Balancing the Budget. The federal budget has been in deficit for 13 straight years and 21 of the last 22 years. The Congress has already approved deficits for the next three years. CBO now projects those deficits to exceed $150 billion in each year, and to be about $170 billion when off-budget spending is counted. The CBO projection assumes that all of the savings contemplated by the budget resolution for fiscal year 1983 will be achieved; if they are not, the outlook is even bleaker.

By five-year periods beginning in fiscal year 1962 and ending with fiscal year 1981, the annual deficit has averaged 0.8, 1.2, 2.1, and 2.0 percent of gross national product (GNP), and in no year did it exceed 4.0 percent of GNP. CBO projects that it will average 4.1 percent of GNP during fiscal years 1982-1985, however, with a peak of 4.7 percent in 1983.

Such persistent and large deficits portend continued difficulties in lowering interest rates and encouraging economic growth. Additionally, when the economy is operating close to capacity, a deficit contributes to inflationary pressures. More-