TABLE 10. CBO'S OPTIMISTIC AND PESSIMISTIC ASSUMPTIONS (By fiscal year)

Assumptions	1982 (Estimated)	Projected 1983	1984	1985	1986	1987
Optimistic Assumption (all economic indicators by fiscal year)						
Current dollar GNP (in billions of dollars)	3,065	3,453	3,859	4,276	4,702	5,130
Current dollar GNP growth rate (annual percentage)	7.2	12.7	11.7	10.8	10.0	9.1
Constant dollar GNP growth rate (annual percentage)	-0.5	5.3	5.2	5.0	4.6	4.0
Unemployment rate (in percents, fiscal year average)	8.8	7.9	6.8	6.2	5.7	5.6
GNP deflator (in percents)	7.8	6.9	6.2	5.5	5.1	4.9
CPI (in percents)	8.2	6.4	6.2	5.9	5.4	5.2
Pessimistic Assumption (all economic indicators by fiscal year)						
Current dollar GNP (in billions of dollars)	3,062	3,399	3,739	4,088	4,454	4,837
Current dollar GNP growth rate (annual percentage)	7.1	11.0	10.0	9.3	9.0	8.6
Constant dollar GNP growth rate (annual percentage)	-0.7	2.9	2.2	2.0	2.0	2.0
Unemployment rate (in percents, fiscal year average)	8.9	8.6	8.4	8.5	8.5	8.5
GNP deflator (in percents)	7.9	7.9	7.6	7.2	6.8	6.5
CPI (in percents)	8.3	7.2	8.1	7.7	7.3	6.9

SOURCE: Congressional Budget Office, Baseline Budget Projections for Fiscal Years 1983-1987 (February 1982).

in fiscal years 1985, 1986, and 1987. As a result of this weak recovery, unemployment remains high throughout the five-year period, declining from 8.6 percent in fiscal year 1983 to 8.5 percent in fiscal year 1987. The rate of inflation also declines more slowly than under the optimistic set of economic assumptions, with the CPI falling from 7.2 percent in fiscal year 1983 to 6.9 percent in fiscal year. 6/

Although this scenario is pessimistic, it is not beyond experience. Recent economic performance has been characterized by a series of recessions separated by weak recoveries. Any Constitutional amendment, moreover, would have to work in a variety of circumstances.

The following budgetary analysis was undertaken with the assumption that adjustments in federal revenues or forces in the nonfederal sectors of the economy resulted in the assumed levels of economic activity shown in Table 10. It could be argued that, unless revenues were adjusted or other factors caused a change in economic activity in the nonfederal sectors of the economy, the cuts below the budget projections that are required by a number of the expenditure limitation bills would prevent the achievement of the economic assumptions that underlie the projections. It is further assumed that the Congress would not exercise its option under each bill to waive the limit. In addition, it is assumed that the Congress decided to spend up to the limit in each year.

In order to compare the effects of proposals with varying implementation schedules, the following analysis assumed that the amendments were fully implemented in fiscal year 1983. In reality many of the proposals contain phasing-in provisions. For example, if passed in 1982 and ratified by state legislatures by October 1983, H.J. Res. 350 would first be effective for fiscal year 1985. In some cases, this assumption would inflate the size of the outlay reductions that the proposals would require. As explained in the previous chapter, because federal receipts will be much lower than federal expenditures, in the near term, implementing H.J. Res. 350--with its planned balanced budget requirement--would require very sharp reductions in federal outlays, equivalent in-

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6/ The association of relatively high inflation with slow economic growth is simply based on assumption to distinguish a pessimistic outlook (for both output growth and inflation) from the more optimistic alternative.

creases in federal receipts, or some combination of the two. So that the reader might better judge the impact of H.J. Res. 350, it was also analyzed under the assumption that the federal budget was balanced in fiscal year 1982 by revenues being raised to equal total federal outlays.

Several of the options, most notably S.J. Res. 58 and H.J. Res. 350, use "national income" as the economic indicator for their limitation formula, allowing the Congress to establish how national income is to be calculated. GNP was used to determine the growth rates for these formulas.

Budgetary Effects Under the Optimistic Assumptions

When the five limitation formulas are analyzed under the optimistic economic assumptions for the fiscal years 1983-1987 period, all but H.J. Res. 169 require the Congress to make reductions from the CBO current policy baseline, and all but H.J. Res. 350 and H.J. Res. 169 would require additional reductions beyond those assumed in the first concurrent resolution for fiscal year 1983. Even under these optimistic assumptions, some of the limitations would require very large reductions. 7/

Under CBO's current policy baseline, federal unified budget outlays would decline to 20.8 percent of GNP in fiscal year 1987, and total budget outlays--including off-budget outlays--would decline to 21.2 percent of GNP. In comparison, H.R. 650 would require unified budget outlays to decline to 20.2 percent. H.R. 702 would require them to fall to 18.0 percent, and S. 1848 would mandate that they drop to 20.6 percent. H.J. Res. 169, which limits total outlays, would allow them to rise to 22.9 percent in fiscal year 1987.

The effect of H.J. Res. 350, which limits total outlays, would depend on whether or not the federal budget was balanced at the time of implementation. As indicated in the previous chapter, if H.J. Res. 350 was implemented during a period of very large and persistent deficits--such as the present one--its balanced budget

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7/ As previously mentioned, any expenditure limitation formula can be adjusted so that it holds the public sector constant, allows the public sector to grow, or requires the public sector to decline.

provisions would require very large reductions in outlays unless the Congress chose to close the deficit by very large tax increases. Thus, if H.J. Res. 350 was implemented in fiscal year 1983 with its large deficit, it would require outlays to decline to 20.6 percent of GNP by fiscal year 1987. By contrast, had the budget been balanced prior to implementation of H.J. Res. 350 in fiscal year 1983, the ratio of federal outlays to GNP would be allowed to be as high as about 24 percent by fiscal year 1987, a limit well in excess of the current policy projection.

Budgetary Effects Under the Pessimistic Assumptions

All the expenditure limitation formulas that incorporate a statistical measure of the economy would require greater outlay reductions under the pessimistic set of econmic assumptions than under the optimistic scenario. For formulas that limit outlays to a percent of GNP, the additional reductions would be needed because current dollar GNP would be lower under the pessimistic assumptions than under the optimistic assumptions.

S. 1848 attempts to avoid this problem by creating a five-year average trend GNP to smooth out the effect of economic cycles. In a normal recession, such a formula would have this effect. But if a recession lasted several years or if the economy experienced a series of recessions separated by weak recoveries--as is hypothesized in the pessimistic scenario--even trend GNP formulas, such as that employed by S. 1848, would require additional reductions in outlays.

H.J. Res. 169 and H.J. Res. 350 would also follow this pattern. Both would limit future outlays by the growth rate of a completed year. The use of a lagged economic indicator would prevent these formulas from becoming more restrictive during the first two years of the fiscal year 1983-1987 period. But during the last three years of the analysis, the continuation of a weak recovery would be felt and each formula would become more restrictive than under the optimistic assumptions.

The Need to Cut Countercyclical Outlays. Under the current federal budget system outlays for certain programs automatically increase as the economy declines (countercyclical outlays). This is particularly true for unemployment compensation and some entitlement programs, such as Social Security, food stamps, and public assistance. CBO currently estimates that a one percentage point drop in the annual growth rate of real GNP will cause budget outlays to rise by $11 billion in three fiscal years. None of the expenditure limitation formulas specifically accounts for the rising outlays caused by declining economic performance. Substituting the pessimistic economic scenario for the optimistic scenario would cause the outlays in CBO's current policy baseline to increase by $152 billion by fiscal year 1987. A similar switch of economic assumptions would cause the outlay estimates based on the first concurrent resolution for fiscal year 1983 to rise by about $80 billion. Thus the requirement of the expenditure limitation measures that spending be curbed when GNP declines must be considered in comparison to unconstrained outlays that otherwise rise during recessions. Limitation proposals would require the Congress to eliminate these countercyclical outlays, cut other programs to allow for them, or vote to waive the limitation formula during prolonged recessions or a series of recessions separated by weak recoveries.

This requirement to eliminate countercyclical outlays or make compensating reductions in other programs reflects a very different view of the relationship of the federal sector to the economy than is now held. Currently, there is general acceptance that, if the economy declines, the federal sector does not have to decline in proportion to GNP. Under current policy, federal budget outlays tend to rise as a proportion of GNP during economic downturns. The authors of S.J. Res. 58 and H.J. Res. 350 would have federal budgeting come to resemble state and local budgeting under which reductions in public services are made during recessions.

Stability of the Limits Over Time

The advocates of S.J. Res. 58 and H.J. Res. 350 point out that over the long run the formulas would hold the size of the public sector constant rather than having it grow or decline as a percentage of GNP. Logically they are correct since growth rates of current dollar measures of national income are applied to both the numerator (the limit) and the denominator (GNP in the budget year being planned) of the proportion.

Under some circumstances, however, the use of a lagged economic indicator to produce the limit could cause either a long-term decline or a long-term increase in the size of the federal sector that is allowed under the limit. For example, in a period of progressively increasing GNP growth rates--caused by progressively increasing rates of inflation, progressively increasing rates of real growth, or both--the rate of GNP growth for the budget year being planned would always be larger than the rate of

98-379 O - 82 - 8

growth that was used to develop the limit. 8/ Under these circumstances federal outlays would shrink as a percent of GNP. Of course this relationship is symmetric. During periods of long-term falling GNP growth rates the formula would allow for a federal sector that steadily grew as a percent of GNP.

As shown in Figure 9, such a long-term decline in the size of the federal sector would have occurred if S.J. Res. 58 or H.J. Res. 350 had been implemented after the balanced budget of fiscal year 1960. This figure compares the five-year moving averages of actual revenues, actual total outlays, and the outlays and revenue limits that would have been created by these resolutions. 9/ Because the rate of inflation has increased almost steadily during the last two decades, the five-year moving average of the limit declines from around 19 percent of GNP for the 1960-1964 period to just over 17 percent of GNP for the 1977-1981 period.

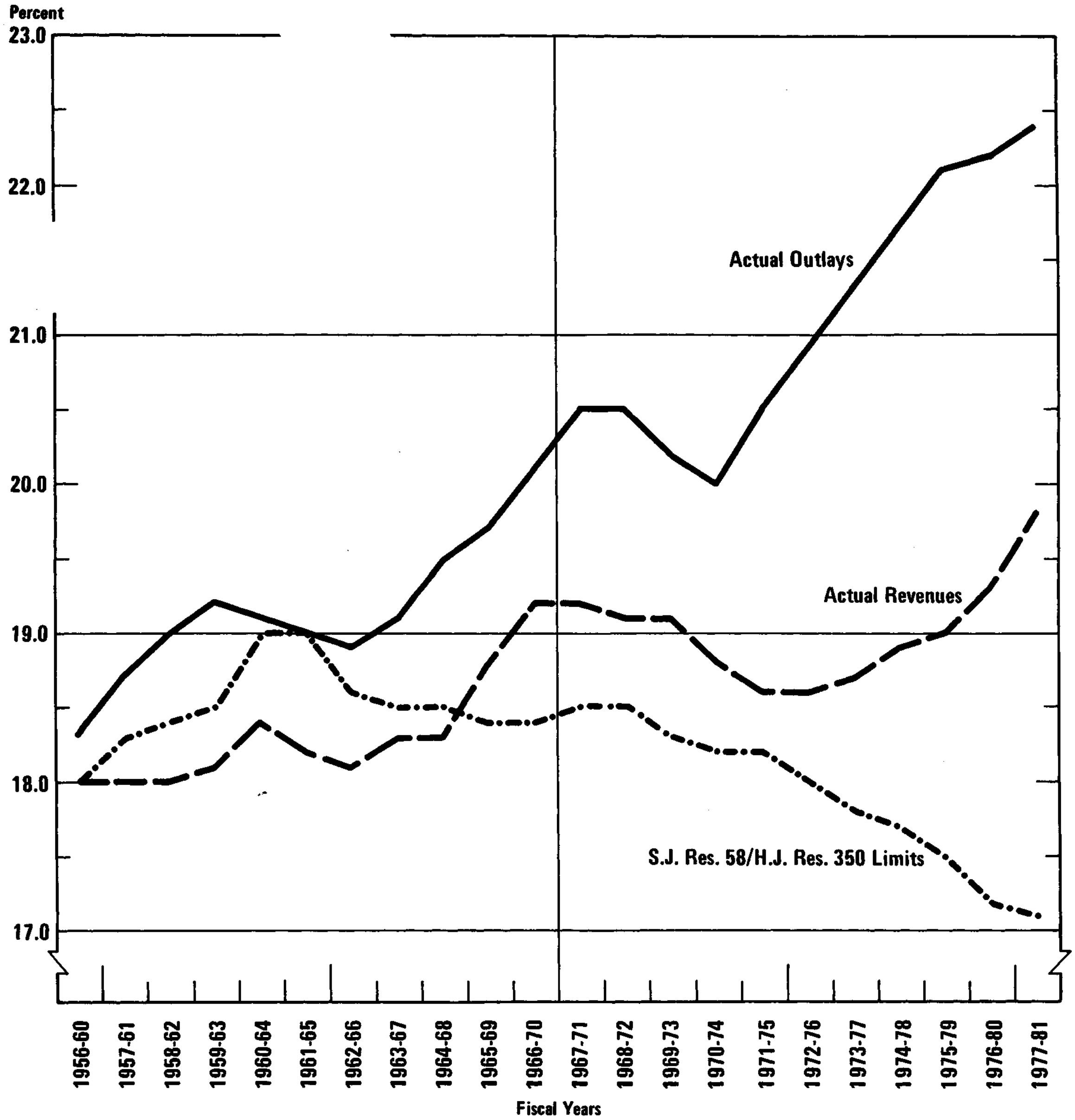
It could be argued that such a steady rise in the rate of inflation could not be sustained for more than two decades and that, when the steady rise was succeeded by the inevitable steady decline, the limit would return to its early 1960 level. Although two decades is a short time in economic history, it spans a political generation. It is an open question whether such a limit in the Constitution could be accepted by the political forces that it seeks to change or control.

8/ For example, if current dollar GNP grew at a 10 percent rate in calendar year 1983 and at a 12 percent rate in fiscal year 1985, the revenue limit (which because of the balanced budget provision sets the outlay limit), for fiscal year 1985 would allow revenues from fiscal year 1984 to 1985 to increase by 10 percent while GNP grew at 12 percent between these two fiscal years. A series of such years would lead to a gradual decline of the federal sector.

9/ The same assumptions are made here as were made for the other estimates in this chapter--namely, that the same economy would have occurred under the limit as was produced with the actual budget policy; that actual revenues would have been at the level of the limit; and that the Congress never chose to waive either the limit provision or the balanced budget prohibition.

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 1961



CHAPTER VII. DIFFICULTIES OF ENFORCING A PROHIBITION

Those who advocate statutory or Constitutional prohibitions of deficits and excessive expenditure growth seek to substitute fairly rigid rules for Congressional judgment. They do so because they believe that the traditional means of budget control cannot combat the bias that exists in representative democracies toward higher and higher expenditures financed through deficits. As such, they are trying to achieve through rules what was, in the past, achieved through belief in the intrinsic value of balanced budgets and a small public sector.

If the advocates of these proposals are correct about the bias of representative democracy, it is probable that there would be attempts to circumvent the intent of the prohibitions. The prohibitions described in this paper would undertake to change behavior patterns through statutory and constitutional rules. Some previous attempts to do so have been at least partially successful. 1/ But other efforts to change behavior through Constitutional sanctions--most notably Prohibition--not only failed but in the process created new sets of problems at least as damaging as those that led to the rule.

A central question for the Congress to address, then, is whether the proposed rules can be successfully implemented or whether they will be circumvented to such a degree that, by widening the gap between promise and performance, they will create a worse situation than exists today. This chapter discusses the difficulties of enforcement that could arise if a prohibition were enacted. 2/ It describes some of the ways that defi-

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1/ For example, the Civil War amendments guaranteeing equal rights for all citizens, although some would argue that most of the achieved success came only a century later, after passage of the Civil Rights Act of 1964. For a review of how the provisions of the U.S. Constitution have affected the substance of American economic policy, see Kenneth W. Dam, "The American Fiscal Constitution," The University of Chicago Law Review, vol. 44, no. 2, (Winter 1977), pp. 271-320.

2/ The following sections rely in part on Allen Schick, Constitutional Limitations on the Budget, Congressional Research Service, February 21, 1979. See Appendix A for greater detail.

cit prohibitions and expenditure limitations might be circumvented.

PROBLEMS OF ENFORCEMENT

Evading the Budget Process Entirely

Assuming that the prohibitions were effective in preventing deficits and checking expenditure growth, those desiring new or enlarged programs could resort to mechanisms outside the unified budget. Four such routes are regulation, government-sponsored corporations, off-budget agencies, and guaranteed loans.

Regulation. Federal regulatory activity in recent years has been expanding at least as fast as federal spending. If a budgetary prohibition was successfully implemented, it is possible that those who want a new federal program would turn to regulations to achieve their ends. If this occurred, the private and state and local government sectors would have to bear the costs. Employers, for example, could be asked to bear the total costs of national health insurance or could be required to keep former employees on the company's health plan up to six months after they were laid off. Unemployment compensation expenditures could be reduced by requiring firms to give six months' notice before laying off or firing their workers. A standard minimum pension plan could be required of all firms. The states and localities could be mandated to bear the full costs of services that are now at least partially covered by the federal government, for example, education for the handicapped. 3/

If significant activities were shifted from budgetary to regulatory status, not only would the intent of the prohibition sponsors be circumvented but the costs would be relatively hidden. To the extent that this was true, it might be even more difficult to limit the growth of regulation than is currently the case with spending.

3/ Some proposed amendments incorporate language to prevent this shifting of the burden to the states or the localities. The National Tax Limitation Committee's proposal, for example, states: "The Government of the United States shall not require, directly or indirectly, that states and local governments engage in additional or expanded activities without compensation equal to the necessary additional costs."

Government-Sponsored Corporations. Government-sponsored corporations are enterprises with completely private ownership that are chartered by the federal government to perform specialized tasks. Their financial operations are not included in unified budget totals. Today there are seven credit corporations--the Student Loan Marketing Association (SLMA), the Federal National Mortgage Association (FNMA), Bank for Cooperatives, Federal Intermediate Credit Bank, Federal Land Bank, Federal Home Loan Bank System (FHLBS), and the Federal Home Loan Mortgage Corporation (FHLMC). In fiscal year 1981 these seven corporations borrowed $33.4 billion, bringing to $161.8 billion their total outstanding debt.

Each of the corporations issues securities that are similar to the "moral obligation," or revenue bonds, issued by public authorities in many states. Although they are totally privately owned:

> Government sponsorship has provided these enterprises with certain characteristics that differentiate them in credit markets from completely private institutions. They have been given special preferences and certain tax exemptions, and their securities may be offered as investments of federally regulated institutions. These advantages give their security obligations a preferred position in the securities markets, enabling them to borrow at rates only slightly higher than those of the Treasury. 4/

Although all the current govenment-sponsored corporations perform specialized credit functions, hundreds of other corporations have been created or chartered since the first Congress. Many of these combined elements of public and private enterprise. 5/ Faced with budgetary limitations, it would not

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4/ Budget of the United States Government, Fiscal Year 1983, Special Analysis F, p. 39.

5/ "These include private corporations which are funded entirely by federal appropriations (e.g. the Legal Services Corporation), private for-profit corporations which have public and private sources of revenues (Consolidated Rail Corporation) and profit-making corporations partly owned by the federal government (National Railroad Passenger Corporation)." Allen Schick, Constitutional Limitations on the Budget, pp. 15-16.

be surprising if the Congress tried to accomplish its programmatic ends through off-budget, semi-autonomous corporations. A national health insurance plan, for example, could be run by such a corporation, as could Social Security.

Off-Budget Agencies. As indicated in Chapter IV, seven federal agencies currently are granted off-budget status by law. In fiscal year 1981 seven of these agencies--the Federal Financing Bank (FFB), the Rural Electrification and Telephone Revolving Fund, the Rural Telephone Bank, the Strategic Petroleum Reserve, the Postal Service Fund, the U.S. Railway Association, and the Synthetic Fuels Corporation--had total outlays of $21 billion. Almost all of this amount has been or will be spent by the FFB to purchase federally guaranteed loan obligations. Because these agencies do not have independent revenue sources, the public debt is increased by the amount of their outlays.

Many of the proposed prohibitions seek to limit the ability of the Congress to shift funding by the use of such terms as "total federal expenditures." In the past, however, the courts have held that budgetary terms are what the Congress says they are. 6/ Careful drafting would be necessary, therefore, to write a prohibition that would prevent a future Congress from granting more and more federal activities off-budget status.

Loan Guarantees. As discussed in Chapter IV, the fastest growing type of federal support is the loan guarantee. 7/ Between fiscal years 1967 and 1981, the total amount of outstanding guaranteed loans increased fivefold to just over $500 billion.

Traditionally, guaranteed loans were used in the housing field to help individual borrowers to become homeowners by reducing lenders' risks in making mortgages. These mortgage insurance programs continue to operate on an actuarially sound basis, charging premiums that are set high enough to cover operating costs and probable losses. Over time, guaranteed loan programs were extend-

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6/ Congressional Research Service, Constitutional Definition of Appropriations, June 4, 1979, p. 3.

7/ Guaranteed loans are contingent liabilities that require federal outlays only in case of default. They are excluded from the current budget resolutions by section 3(a) (2) of the Congressional Budget Act.

ed to marginal borrowers--students for education costs and low-income families seeking homes. Although these loans pose greater than normal risks, the government's guarantee of repayment in case of default (and, for student loans, direct subsidy of part of the interest) encourages lending institutions to make these loans at interest rates below what they would normally charge for high-risk loans. Thus, the government, in effect, provides a subsidy to the borrowers. In recent years, guarantees of very large loans have been granted to a single borrower or to a small group of borrowers running common risks--for example, New York City, the Chrysler Corporation, and synthetic fuel manufacturers. Increasingly, therefore, loan guarantees are providing large subsidies for a small number of borrowers. As such, they provide a classic target of opportunity for those wishing to circumvent statutory or constitutional restrictions on the budget.

Creating Two Budgets: The Capital Budget

Faced with limitations on the unified budget, the Congress might choose to follow the examples of private industry and many state and local governments by placing capital expenditures in a separate budget. A capital budget traditionally is a means of accounting for long-term borrowing used to finance the construction and purchase of physical assets. Such a budget strategy separates regular operating expenses from investment in physical capital assets.

Those in favor of capital budgeting contend it would foster long-range planning, standardize budget treatment of out-year costs, and provide a better tool to determine the appropriate level of debt. Most economists, however, think that the capital budget is an inappropriate tool for federal budgeting. They believe that the needs of the economy, rather than the desired level of capital investment, should govern the federal government's borrowing policy. 8/ In addition, there is some concern that, if capital outlays could be financed through borrowing while operating outlays would have to be financed through taxation, a bias would be created toward capital spending. For example, the government might help localities buy buses but not subsidize carfares.

8/ Maynard S. Comiez, A Capital Budget Statement for the U.S. Government (Washington, D.C.: The Brookings Institution, 1966).

While the federal government does not have a capital budget or issue long-term bonds for specific capital projects, the Office of Management and Budget (OMB) does tabulate those federal outlays that might be funded through a capital budget should the Congress desire to do so. It appears, however, that many of the federal outlays that are frequently classified as capital expenditures would not be so budgeted either in private industry or by state and local governments. In addition, those who espouse a capital budget overlook that outside the federal government money has to be set aside to cover repayment of the principal of the capital bonds.

According to OMB, the federal government spent $146.0 billion on investment in fiscal year 1981, with $70.4 billion allocated to physical assets and the remainder to investment in education and "human" capital development. 9/ This $146.0 billion, however, does not take into account any appropriations needed to service associated debt if these expenditures were moved in a capital budget. (Traditionally, state and local governments make yearly appropriations into a sinking fund in order to redeem capital expenditure bonds when they come due.) Thus, the actual amount of outlays that would escape unified budget coverage would equal the amount raised from long-term capital bonds minus the amount appropriated (and thus carried as additional outlays in the unified budget) to be set aside to retire the bonds eventually.

In a 1979 study conducted for the Congressional Budget Office at the request of the House and Senate Budget Committees, the consulting firm of Peat, Marwick, and Mitchell (PMM) translated the federal budget for fiscal year 1978 into the budget formats of four states: California, Illinois, Maryland, and New York, all of which use a capital budget. 10/ (A fuller description of the study's findings and methodology is set out in Appendix A.)

Following an agreed-upon rule to include in a federal capital budget only those federal outlays that were equivalent to each state's capital spending, PMM calculated that between $20.7 billion and $32.2 billion of fiscal year 1978 federal outlays would

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9/ Budget of the United States Government, Fiscal Year 1983, Special Analysis, pp. 85-101.

10/ Peat, Marwick, Mitchell and Company, A Comparative Analysis of Federal and Selected State Financial Data (study prepared for the Congressional Budget Office, April 1979).

qualify for a state-like capital budget. The major category of investment spending (as defined by OMB) excluded from their calculations was the $20.9 billion for acquisition of major military equipment. Using a typical repayment schedule, PMM estimated that, if the federal government had a capital budget and followed state practice, an amount equivalent to 30 percent of the fiscal year 1978 bondable capital outlays would have to be appropriated (on budget) for placement in a bond repayment fund. 11/ Following the practice of these four states, therefore, PMM estimated that the existence of a federal capital budget would have shifted from $14.5 to $22.5 billion from the unified to the capital budget, thus escaping the expenditure limit and lowering the deficit (see Table 11).

TABLE 11. REDUCTION IN UNIFIED BUDGET RESULTING FROM HYPOTHETICAL FISCAL YEAR 1978 FEDERAL CAPITAL BUDGET FOLLOWING THE BUDGETARY PROCEDURES OF FOUR STATES (In billions of dollars)

	California	Illinois	Maryland	New York
Estimated Bondable Capital Outlays by State Definitions (reduction of federal budget outlays)	-27.6	-32.2	-27.5	-20.7
Estimated Associated Debt Service Principal Repayment (additions to federal budget outlays)	+ 8.2	+ 9.7	+ 8.2	+ 6.2
Net Adjustment (total reduction of federal budget outlays)	-19.4	-22.5	-19.3	-14.5

11/ It should be noted that under current federal practice an appropriation to a bond repayment fund would not be counted as an outlay.

It is possible, of course, that a Congress seeking to avoid a budgetary restriction would include the entire $70.4 billion spent on physical capital investment in fiscal year 1981 in its capital budget and continue the current federal policy of not appropriating funds for repayment of debt principal. In such a case, total expenditures and the deficits or surpluses would be adjusted by this full amount.

AVOIDING AN EXPENDITURE LIMITATION

The previously discussed strategies could be used to avoid either a balanced budget rule or an expenditure limitation. There are two additional ways of initiating or enlarging federal programs while complying with a limitation on spending growth: increasing the use of accounting practices that minimize total outlays and expanding the use of tax expenditures.

Manipulating the Definition of Outlays

Outlays are generally thought to occur whenever the federal government pays out funds. While what constitutes an outlay is not in question, the use of various accounting techniques could be expanded to minimize outlays for budget purposes. Some of these techniques could significantly lower the total of outlays carried in the budget.

Receipts as Negative Expenditures. There are a number of receipts that, for federal budget purposes, are treated as negative outlays (that is, subtractions from outlays) rather than revenues. These offsetting receipts arise from intergovernmental transactions (mostly involving payments to and from trust funds) and from the sale of government assets such as the leasing of rights to search for oil on the Outer Continental Shelf. While there are legitimate economic reasons for this accounting practice, it is also true that, if they had been counted as revenues rather than as negative outlays, total unified budget outlays in fiscal year 1981 would have been $104.3 billion, or 15.9 percent, higher.

Counting receipts as negative expenditures could also be used to manipulate outlay totals at the estimation and execution stages of budgeting. In the past, for example, administrations have submitted unrealistic estimates of expected receipts from Outer Continental Shelf oil leases and royalties. Because leases are granted through a bidding process, budget planners could lower their estimates for total outlays and the deficit by anticipating very successful auctions. When these failed to occur, actual outlays would be several billion dollars higher than anticipated.

Offsetting receipts also occur when the federal government sells loan assets. When the government issues securities known as certificates of beneficial ownership (CBOs), the transaction is viewed as an exchange of assets. By increasing the volume of CBOs sold in any given year, the Executive Branch could reduce the level of expenditures by increasing the level of negative outlays.

Expanded Use of Tax Expenditures

Tax expenditures--revenue losses resulting from provisions in the tax code that provide preferential tax treatment for certain groups of taxpayers--have been increasing at a faster rate than outlays in recent years. Since fiscal year 1975, they have risen by 121.5 percent to an estimated $228.6 billion in fiscal year 1981. This represents an average annual growth rate of 16.4 percent since 1975. Outlays have grown at an average of 12.5 percent annually over the same period.

In many budget functions--such as Commerce and Housing and General Purpose Fiscal Assistance--tax expenditures are the predominant method of federal assistance. In a number of other budget functions--International Affairs; General Science, Space, and Technology; Energy; Agriculture; and Education, Training, Employment, and Social Services--they make up at least a fifth of all federal support.

The successful implementation of an expenditure limitation would probably lead to additional tax expenditures. 12/ Such an expansion would reduce the revenue burden and could further reduce the fairness of the tax system in that individuals with the same amount of income and from the same types of families would be paying different amounts of taxes.

As indicated in Chapter V, H.R. 6021, introduced by Representative Giaimo in the 96th Congress, attempted to close this potential loophole by applying a limiting formula to the sum of

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12/ Of course, the expanded use of tax expenditures could not be used to avoid a balanced budget amendment.

outlays and tax expenditures. Other alternatives would be to include tax expenditures in the budget resolutions or to require that any sunset provisions that are adopted by the Congress must apply to tax expenditures as well as to outlay programs. 13/

LOSS OF CONGRESSIONAL AUTHORITY

The adoption and implementation of a balanced budget rule or an expenditure limitation would result in loss of Congressional authority in two ways. First, these proposals, by their very nature, seek to reduce Congressional flexibility in budget-making. As previously stated, many critics of the present budget process see flexibility, particularly in determining fiscal policy, as the cause of many of America's economic problems. Others see fiscal policy as a central function of government, whatever are the imperfections in implementing it.

Second, a sringent budget rule would, in all probability, shift the responsibility for economic policy from the Congress to the Federal Reserve, the courts, and/or the President, or all three. As discussed in Chapter V, under a balanced budget rule, fiscal policy would largely be removed as a tool of discretionary economic policy, with increasing reliance placed on monetary policy. As such, Congressional authority over economic policy would decline while that of the Federal Reserve would increase. Under these circumstances, the Congress might choose to exert greater control over the Federal Reserve.

The courts would gain budgetary power because they might be asked eventually to enforce the prohibition against a possibly reluctant Congress. Several proposals, for example, include provisions stating who can sue whom in what court to enforce the proposed act.

A shift of authority from the Congress to the President would be a possible alternative to court enforcement. Several states require that their Governor ensure that expenditures do not exceed revenues. Several of the proposals before the Congress would re-

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13/ These alternatives are discussed in Congressional Budget Office, Tax Expenditures: Current Issues and Five-Year Budget Projections for Fiscal Years 1981-1985 (April 1980), pp. 9-17.