Making the US federal budget

Process and hazards

SUMMARY

The federal budget makes up roughly half of all public spending in the US, with the rest spent at state and local level. The United States (US) Congress, comprising the House of Representatives and the Senate, is responsible for passing the legislation that constitutes the budget, but the President also plays an important role, both in launching the process through a formal budget proposal and in bringing it to an end by signing appropriations, revenue and entitlement bills into law.

While the budget process is formally set out in legislation, budget-making in practice can be quite different. The Constitution grants the 'power of the purse' to Congress, but it is ultimately the President who signs bills into law. This de facto division of powers between President and Congress, and within Congress between the House of Representatives and the Senate, poses specific challenges – not least when the House, the Senate and the Presidency are controlled by different parties.

These challenges have been conspicuous in recent years, as lawmakers have struggled to follow the prescribed timetable, necessitating other procedures and stopgap measures to maintain funding for vital government functions. In addition, in response to mounting government debt and political deadlock, attempts have been made to bind future legislatures, by locking in budget cuts in a process known as 'sequestration'.

At times the key players have been unable to reach agreement, cutting off funding from parts of the government and putting the US at risk of a sovereign default.

In this briefing:

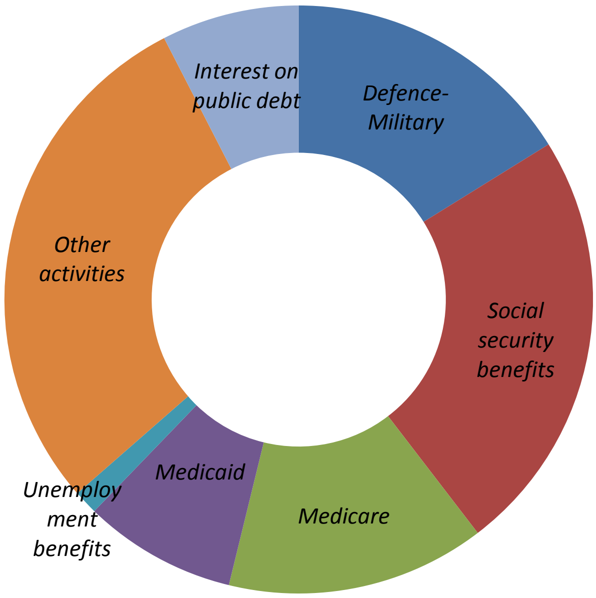
EPRS | European Parliamentary Research Service
Author: Matthew Parry
Members' Research Service
PE 551.318

Size and composition of the federal budget

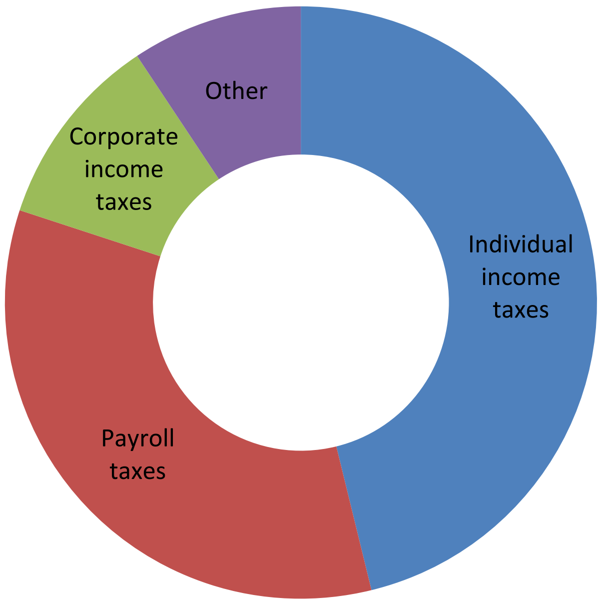
The federal budget for the 2014 United States (US) fiscal year (1 October 2013 to 30 September 2014) was $3 504 billion, or 20.3 percent of US GDP, up from $3 454 billion in fiscal year 2013. The budget for 2014 comprised $3 021 billion in receipts and $483 billion in borrowing. The chief sources of revenue were income taxes ($1 395 billion), payroll taxes ($1 024 billion) and corporate income taxes ($321 billion), while the biggest outlays were social security benefits ($840 billion), defence ($578 billion) and the national health insurance schemes Medicare ($509 billion) and Medicaid ($301 billion). Part of the budget is spent by state and local governments in the form of federal grants ($607 billion in the 2011 fiscal year).

The federal budget is divided into mandatory (or 'direct' or 'entitlement') spending and tax legislation on the one hand, and discretionary spending on the other. Mandatory spending accounts for more than half of the budget and, like tax legislation, continues automatically, unless the legislation underpinning it is changed. It includes social security, Medicare and Medicaid, each of which are also known as entitlement spending, since the amount spent on each depends on eligibility criteria spelt out in legislation.

Spending



Receipts



Source: Congressional Budget Office, Monthly Budget Review, Summary for FY 2014.

Discretionary spending requires the approval of Congress each year, as it takes the form of annual congressional appropriations bills. Approximately a third of the budget is discretionary, including all defence spending. Between five and ten per cent ($271 billion in the 2014 fiscal year) of the budget is interest on existing public debt.

By the book: how the budget is meant to take shape

Under the 1974 Congressional Budget and Impoundment Control Act (CBA), the budget is meant to comply with an annual 'budget resolution' by both houses of Congress in response to a proposal by the President. The process can be summarised in three steps.

Step one: the President's proposal

The President, assisted by the White House Office of Management and Budget, and on the basis of data from federal agencies, submits a detailed proposal for the federal fiscal year beginning on 1 October by the first Monday in February, setting out spending in each category and programme under 'budget accounts', as well as expected tax revenue and, when the two do not match, the size of the surplus or deficit, with the latter being financed through borrowing. The President may, but need not, propose changes to entitlement spending or tax legislation. To illustrate the long-term implications of his or her recommendations, the President's proposal also details fiscal policy and budgetary priorities for the following ten years.

Step two: the congressional budget resolution

In response, the House of Representatives and Senate Budget Committees each draft and adopt their own budget plans, or 'budget resolutions', based on 'views and estimates' of spending and revenue submitted by other committees. The budget resolutions are subsequently put to a vote in each chamber and then reconciled at a House-Senate conference in the form of a joint congressional budget resolution and report. The resolution specifies the total amounts that their respective Appropriations Committees can authorise in each of 19 budget functions, the expected overall amount of revenue, and an appropriate level of public debt. Under the CBA, the congressional budget resolution must cover a period of at least five years, including projected revenue, even though the budget process provides for a new resolution every year. The House and Senate are supposed to pass their joint resolution by 15 April.

The congressional budget resolution is not like a legislative bill; it cannot enact spending or tax law and does not require the President's signature (and thus cannot be vetoed). Instead, it sets spending caps under which the House and Senate Appropriations Committees can draft bills authorising discretionary funding. The resolution can also provide instructions to other committees to draft bills adjusting mandatory tax or spending legislation. If Congress attempts to pass legislation that contradicts the budget resolution, it can be blocked by a point of order – a formal procedural objection – in either the House or the Senate. In the House a simple majority suffices to waive a point of order, but in the 100-seat Senate, 60 votes are required, making it an effective tool for enforcing the terms of the budget resolution.

Step three: Congress legislates

While the resolution divides the maximum funding levels by budget function, the report attached to the resolution divides them by congressional committee in what are referred to as 302(a) allocations, because they are provided for in Section 302(a) of the CBA. The House and Senate Appropriations Committees, which are responsible for discretionary spending, each receive their 302(a) allocation and divide them further between their various subcommittees (12 each) into 302(b) sub-allocations. The subcommittees then draft appropriations bills to be passed by Congress. The other committees responsible for mandatory spending also receive allocations, which are effectively spending caps or revenue floors governing legislation within their remit. The budgetary impact of appropriations bills and mandatory tax and spending legislation (i.e. how much they will ultimately cost in new spending and changed revenue) must fit within the scope allowed by the budget resolution, both for the forthcoming fiscal year and, in terms of its longer-term repercussions, subsequent years covered by the resolution. The Budget Committees 'score' the cost of proposals, usually based on an assessment by the politically neutral Congressional Budget Office.

Like other bills, congressional bills adjusting direct spending and revenue or authorising discretionary spending must be signed into law by the President, giving him or her the power to block budgetary measures by Congress. Consequently, while the President's budget proposal at the beginning of the cycle has no legal force, he or she does have real sway. Interaction between the executive and Congress continues throughout the budget process – informally in discussions and formally through the issuance of Statements of Administration Policy, with which the President can threaten to veto Congress's proposals. A two-thirds majority is required in each of Congress's two houses to overrule the President's veto.

Making the budget in practice

Failure to pass a budget resolution

It has become increasingly common for Congress not to reach agreement on a joint budget resolution by the 15 April deadline – not least when the House and Senate are controlled by different parties. In this case, existing legislation on tax and direct spending continues to apply, but no authorisation is given for discretionary spending, which includes much of defence expenditure (greater than all the other discretionary spending categories combined) and amounts to approximately a third of the federal budget. To secure funding in these categories, Congress may instead pass an ad hoc 'deeming resolution' focused on discretionary spending and any desired changes to mandatory spending and revenue in those areas where a deal can be struck. Such deeming resolutions can serve as a stopgap measure if agreement on a formal budget resolution is unlikely before the 15 April deadline, or as a replacement when it proves impossible, as was the case for the 1999, 2003, 2005, 2007, 2011, 2012 and 2013 fiscal years. Another alternative is for Congress to pass a budget in the form of a single ordinary bill, such as the 2013 Bipartisan Budget Act.

Continuing resolutions

The Appropriations Committees and their subcommittees are responsible for drafting discretionary funding bills. If they do not complete their work before the beginning of the forthcoming fiscal year on 1 October, Congress must pass, and the President must sign, a 'continuing resolution' to maintain funding in the coming weeks or months for agencies and programmes dependent on annual discretionary appropriations. Failure to agree between Congress and the President forces the closure and suspension of these agencies and programmes, as occurred in October 2013 for 16 days during a deadlock between President Barack Obama and House Republicans. At the time of writing, March 2015, the US Government faced another potential government shutdown as Congressional Republicans threatened to cut domestic security funding in protest against immigration reforms introduced by the White House.

Budget reconciliation

The budget resolution includes non-binding assumptions on mandatory spending and revenue legislation, but it can also prescribe and expedite specific changes by including a 'reconciliation directive' instructing the relevant tax and mandatory spending committees to produce a reconciliation bill with specific provisions by a given date. Reconciliation was originally conceived as a way of limiting the deficit, but under the George W. Bush administration it was used to hasten tax cuts through Congress, thereby reducing revenue and increasing deficits. A number of constraints have since been placed on reconciliation: it cannot be used to increase mandatory spending, authorise discretionary appropriations or increase the deficit, and only items with direct fiscal implications may be included in a reconciliation bill. A point of order can be raised in the Senate to enforce these rules, which can only be waived by at least 60 votes. The 2010 Health Care and Education Reconciliation Act, which amended part of the 2010 Patient Protection and Affordable Care Act (popularly known as 'Obamacare'), was passed as a reconciliation bill, for example.

Deficit-control measures

In response to mounting national debt and projected multi-year deficits, Congress has passed laws in recent years to rein in the federal deficit by imposing additional limits on the budget process. Examples include the 2010 Statutory Pay-As-You-Go Act, under which adjustments to taxes or mandatory spending with long-term budgetary implications must be offset by other tax and spending changes to avoid adding to future deficits; and the 2011 Budget Control Act (BCA), which put in place caps for discretionary appropriations (including defence) through to 2021. Failure to comply with Pay-As-You-Go triggers 'sequestration', or across-the-board cuts, to restore budget neutrality. The BCA provides for additional, automatic sequestration every year to discretionary and some mandatory spending until 2021, so that deficits come down by default, unless Congress and the President can agree otherwise. These automatic cuts are shared between defence and non-defence spending, so that traditional Democrat and Republican priorities are both at stake.

Negotiating the 2016 budget

President Obama presented his budget proposal for the 2016 fiscal year on 2 February 2015. It calls for approximately $3 999 billion in mandatory and discretionary spending and payment of interest on the national debt, and projects total revenue of $3 525 billion. The budget would exceed spending caps set under the 2011 Budget Control Act by $74 billion, with this excess distributed equally between defence and non-defence expenditure. Representatives and Senators – both houses have been controlled by the Republicans since January 2015, following the mid-term elections in November 2014 – have already made clear that they plan to resist any attempt to exceed statutory spending caps.

Political and economic hazards

Sequestration, government shutdown and the fiscal cliff

Because discretionary spending makes up such a large part of the federal budget, failure to pass appropriations bills or the onset of sequestration can have profound consequences. Not only can they shut down parts of the federal government, forcing its employees to be furloughed and preventing agencies from making new purchases, they can also significantly reduce aggregate demand in the economy. The US faced this prospect at the beginning of 2013, when political deadlock over the budget, coupled with the looming expiry of tax cuts introduced under the George W. Bush administration, would have raised taxes and cut spending at a time of economic fragility, pushing the country over a 'fiscal cliff'. The Congressional Research Service (CRS) calculated that this would have cut economic growth that year from 4.4 to 0.5 per cent, and increased unemployment by 2 million.

The debt ceiling and the risk of default

Deficits must be funded through borrowing, but the federal government is constrained by a statutory public debt ceiling. Successive deficits require the ceiling to be raised periodically through legislation to allow for the growing debt. If Congress refuses to lift the ceiling, the Treasury can no longer issue the debt needed to pay obligations incurred through existing policy and legislation, effectively forcing the federal government into a sovereign default. The debt ceiling has been used each year since 2011 as a bargaining chip in negotiations over the budget, with a majority in Congress threatening to withhold support for a higher ceiling unless further budget cuts are made.

Main references

A. J. Auerbach, 'Federal Budget Rules: The US Experience', NBER Working Paper No. 14288, National Bureau of Economic Research, August 2008.

Federal Budget Process: A Primer, Peter G. Peterson Foundation, 30 April 2014.

C. D. Gomes, *Background note for a delegation of the European Parliament's Committee on Budgets to Washington DC*, Policy Department D: Budgetary Affairs, European Parliament, 4 July 2013.

R. Haskins, *Congress Kicks the Can Down the Road: Chapter 100*, The Brookings Institution, 22 December 2014.

B. Heniff Jr, *The Congressional Budget Process Timetable*, Congressional Research Service, 20 March 2008.

B. Heniff Jr, M. S. Lynch and J. Tollestrup, *Introduction to the Federal Budget Process*, Congressional Research Service, 3 December 2012.

C. Maurin de Fariña and P. Car, *US Congress supporting agencies for the budget*, European Parliament Liaison Office with US Congress, 9 December 2011.

Policy Basics: Introduction to the Federal Budget Process, Center on Budget and Policy Priorities, 10 September 2014.

D. Rafferty, D. Sauter Regan, and J. Shakin, *Monthly Budget Review: Summary for Fiscal Year 2014*, Congressional Budget Office, 10 November 2014.

J. V. Saturno, *Points of Order Limiting the Contents of Reconciliation Legislation: In Brief*, Congressional Research Service, 29 January 2015.

J. V. Saturno, *The Congressional Budget Process: A Brief Overview*, Congressional Research Service, 22 August 2011.

Disclaimer and Copyright

eprs@ep.europa.eu
http://www.eprs.ep.parl.union.eu (intranet)
http://www.europarl.europa.eu/thinktank (internet)
http://epthinktank.eu (blog)