Stanford, California
Sunday, January 16, 2011

MEMORANDUM FOR NEW MEMBERS OF THE HOUSE OF REPRESENTATIVES
FROM: KEITH HENNESSEY[1]
SUBJECT: INTRODUCTION TO THE FEDERAL BUDGET PROCESS

As a new Member of the House you will cast several important early votes on budget issues. This memo is a crash course on the federal budget process. I assume you're starting fresh.

You will need a deeper understanding than I provide here to participate in the budget process. I'll help you build the puzzle frame and show you what the picture on the box looks like, and over time you can assemble the rest of the puzzle. This memo therefore leaves out many important but, I think, secondary process elements that you can learn later.

This is a process memo. If you find this helpful, please let me know and I'll write more about the substance of particular fiscal issues.

The budget resolution

Congress dominates the budget process, not the President.

Congress starts by passing a blueprint called the *budget resolution* in the spring. The budget resolution sets the <u>total</u> amount of federal spending, revenues, and deficits[2] for the next five (or sometimes ten) years. Oversimplifying, the budget resolution consists of lists of numbers and process rules written as legislative language.

The budget resolution is a *concurrent resolution*. This means that (if successful) the House and Senate must pass identical legislative language, but it does not go to the President for his signature or veto. This is why it's called the <u>Congressional</u> Budget Resolution. This initial Congress-only process step is a principal source of Legislative Branch power relative to the Executive Branch.

By itself the budget resolution does not spend a single dollar or raise any tax revenue. It is to spending legislation what a blueprint is to a house: a plan, a set of guidelines, constraints, and rules that the builders must follow.

The budget resolution is crafted in the House and Senate Budget Committees, led by their Chairmen, Rep. Paul Ryan (R) and Sen. Kent Conrad (D). They are the most important people in the budget resolution process early in the year. The legislative lead then shifts to other Committee chairs who write individual bills that conform to the budget resolution.

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[2] Or, in theory, surpluses.

In addition to setting totals, the budget resolution also divvies up total spending by committee. The Committees of which you are a member are each given a spending allocation[3] by the budget resolution. This number constrains legislative action by the committee over the next year. The House Ways & Means Committee and Senate Finance Committee handle all revenues.

Each committee then acts throughout the calendar year to pass bills that stay within the numeric constraints established by the budget resolution.

At this point the road forks into two types of spending: *discretionary* spending (aka *appropriations*), and *mandatory* spending (aka *entitlements*). This is a critical distinction that you need to understand.

Discretionary spending through annual appropriations bills

About 30% of total federal spending, classified as *discretionary* spending, is assigned to the Appropriations Committee. The House Appropriations Committee Chairman (Rep. Hal Rogers) will further divide his committee spending allocation into 12 subcommittee spending allocations.[4] Beginning in late spring, these 12 subcommittees and then the full Appropriations Committee will write 12 appropriations bills.

If all goes smoothly, the House will pass all 12 bills. The Senate has a parallel process. Each of these bills will go to a conference committee. Compromise versions will be repassed in the House and Senate and will then go to the President for his signature or veto. Twelve new laws will be enacted before the new fiscal year begins on October 1. All rarely goes smoothly.

In addition to the suballocation among 12 subcommittees, there's an important division within the appropriations pie between defense and nondefense spending. Sometimes this division is set by the budget resolution, and sometimes it's left to the discretion of the Appropriations Committee Chairman (often with "guidance" from House Leadership). Radically oversimplifying, Republicans tend to prioritize defense spending more highly than Democrats do, relative to nondefense spending.

The keys to discretionary spending are:

- It is decided annually. This means Congress spends a lot of time on these bills and the thousands of spending decisions contained within them.
- Congress must act for money to be spent each year. If Congress fails to enact one or more of the 12 appropriations bills by October 1, the programs in that bill will stop operating on that date. The default is that no money will be spent.
- Most of the functions you think of as "the federal government" are funded through these annual appropriations bills.

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[3] You might hear this called a "302(a) allocation," based on the section of the Budget Act that creates this process.

[4] These appropriations subcommittee allocations are called "302(b) allocations."

The appropriations process begins with a *baseline* amount for each discretionary spending program. The baseline assumes for each program that we will spend next year what we are spending this year, usually plus an allowance for inflation. If $100M is being spent for program X and the topline appropriations baseline inflation adjustment is 2%, then the baseline for program X for next year will be to spend $102M.

The 12 Appropriations Subcommittee Chairs lead their committees in a process that then moves these baseline figures for each program up or down to conform with their overall subcommittee spending allocation. If a bill would spend $104M on program X next year, that is often characterized as a "$2M increase above baseline." If a bill would spend $101M on X next year, then those who want to spend more will characterize this as a "$1M cut [below baseline]," while the Subcommittee Chairman might describe it as a "$1M increase [above last year's level]." Even though both agree on the actual amount being spent ($101M), this differential framing of "cut" vs. "increase" can influence press coverage and Members' votes.

Congress often fails to complete their appropriations work on time. Just before the new fiscal year begins on October 1, the Congress will therefore typically pass a short-term *continuing resolution* (CR). The CR is an appropriations bill that funds all discretionary spending programs not yet covered by an enacted appropriations law. A CR is a temporary holdover measure to keep these parts of government operating while Congress finishes its work.

A CR might therefore cover all discretionary spending, as it did last year when Congress failed to enact any of the 12 appropriations bills. Or it could cover any subset of that spending if some but not all of those bills have already become law.

If a CR is not enacted by October 1 (or by the date when the prior CR runs out), then those parts of the federal government not funded "shut down." This is a significant policy impact and even more significant politically.

A CR generally declares a truce by continuing spending for all programs at last year's level, sometimes + or – a small percentage amount across the board. Reallocation fights stay in the regular appropriations process while the truce keeps everything going the way it was.

A CR can last for days, weeks, months, or the remainder of the fiscal year (until September 30th).

The current Continuing Resolution was a long-term one, signed into law on December 22nd of last year and funding all discretionary programs through March 4, 2011. It is the fourth CR enacted since September 30th. Congress will therefore have to decide by March 4th whether to:

- extend this CR through the end of this fiscal year;
- extend it for a shorter time and revisit the decision later; or
- enact some or all appropriations bills so that no CR is necessary.

Mandatory spending

About 70% of total spending is classified as *mandatory* spending. *Mandatory* is a technical term, not a normative one.

Most mandatory spending consists of entitlements established by a formula. Examples include:

- If you've worked a certain number of years over your life and you reach age 62, you are legally entitled to a Social Security benefit determined by a formula written into the law.
- If you're a senior citizen or disabled, you are legally entitled to health benefits under the Medicare program, and doctors, hospitals, health plans and other health providers are paid by the government for providing you with those benefits.
- If you're unemployed and meet certain criteria, you are entitled to unemployment insurance payments.

Mandatory spending differs from discretionary spending in several important ways:

- It's on autopilot. This spending continues until Congress changes the laws that create the entitlements. If Congress does not act, the spending continues.
- Mandatory spending programs therefore often will operate for several years without Congress changing them.
- Relative to discretionary programs which must fight each year for their funding, mandatory programs therefore enjoy a protected status. Since it's hard to pass legislation, defaulting to autopilot allows spending advocates to defend more easily previously legislated spending increases.
- Entitlement spending is set in law by creating eligibility criteria and a payment formula.
- While most of the <u>programs</u> in the government are funded by discretionary spending, most of the <u>money</u> goes out through mandatory spending.

The big three entitlements are Social Security, Medicare (health care for seniors and the disabled) and Medicaid (health care for poor people, the disabled, and some middle class seniors). Other significant mandatory programs include many farm subsidy programs, some welfare programs, and unemployment insurance.

Interest on the debt is classified as mandatory spending, although it's usually not thought of as an individual entitlement.

The (eligibility criteria + payment formula) nature of entitlement programs is important relative to discretionary spending. The baseline for an entitlement program is whatever the experts estimate will happen under the eligibility criteria and payment formula next year, independent of what happened last year. If we expect the unemployment rate to rise over the next year, then the baseline for unemployment insurance (UI) will be higher for next year than actual spending this year, and maybe much higher. If we expect the unemployment rate to fall, then the baseline spending for UI will decline.

Similarly, baseline spending for Social Security is driven by demographics and economic conditions. As Baby Boomers are now retiring, the number of people newly eligible for benefits each year grows, and the spending baseline grows with it.

This leads to an important inequity between programs funded through discretionary spending and those funded through mandatory spending. Suppose the baseline for federal spending on national parks increases by 2% because it's discretionary spending. Baseline Medicare spending is projected to increase more than 7% next year. If Congress decides to enact laws so that spending on each program would increase by 5%, the budget process will describe these policies as a large spending increase for national parks, and a large spending cut for Medicare. Medicare advocates will point out that the demands on their program have increased because there are more seniors and health care prices are increasing rapidly, but the parallel situation might also be true for national parks or other discretionary programs.

While all discretionary appropriations spending goes through the House and Senate Appropriations Committees, mandatory spending is spread out across several committees, each of which is allotted a (mandatory) spending allocation by the budget resolution. If laws are passed this year to change a mandatory spending program, that legislation must not increase the spending within each committee's jurisdiction by more than the amount allotted to it by the budget resolution. The budget resolution committee allocations therefore determine how easy or hard it is for each committee to pass new legislation. If a committee's allocation is increased above baseline, the committee has money to spend. If it is below baseline, that committee is required to change programs within its jurisdiction to spend less than they otherwise would under current law.

Cutting mandatory spending is legislatively difficult. It is often done across several committees in the same year as part of a broad effort to cut spending and reduce the deficit. The budget resolution can but does not have to create the opportunity for a *reconciliation bill*. The budget resolution instructs other committees to save certain amounts of mandatory spending on programs within their jurisdiction. It can also tell the Ways & Means Committee to raise (or cut) taxes. If the budget resolution creates a reconciliation bill, it gives committees a deadline to report legislation. These different bills are then packaged together into a single reconciliation bill that is brought to the House floor. When used for deficit reduction, the idea is one of shared sacrifice: all the committees are chipping in saving to meet a shared deficit reduction goal.

The reconciliation process is even more important in the Senate, because a reconciliation bill cannot be filibustered. A unified majority of the Senate can therefore pass such a bill, unlike almost all other legislation which can be blocked by a determined 41-vote minority.

The reconciliation process was originally (in the 80s) used for deficit reduction. It has also been used for other purposes by Republicans (to cut taxes) and by Democrats (to enact health care changes).

The debt limit

Since the government is running annual budget deficits, the tax revenues coming into the government are insufficient to pay the spending commitments made by the government. Treasury must therefore raise cash to pay the bills by borrowing funds from capital markets. Their ability to do so is capped by a law colloquially called the *debt limit*.

I will save a discussion of the different ways to measure government debt for a later more detailed memo on the debt limit. For now, I hope it suffices to say that the government needs to have the legal authority to borrow the cash needed to pay the bills.

Like a continuing resolution needed to prevent much of the government from shutting down, the debt limit bill is therefore considered a must-pass bill. This year that has led to discussion about whether the must-pass nature of this legislation can be used as leverage. Some fiscal conservatives hope they can use this bill to force the President and his legislative allies to agree to spending cuts or budget process reforms. I'll discuss both the substantive and strategic aspects of that in my next memo.

Sequence

While initial public discussion this year has focused on the debt limit, that might not be the first budget vote you cast.

- The current continuing resolution expires on March 4^{th}. Some vote will be needed by then.
- The budget resolution usually comes to the House floor in mid-March.
- Treasury says the current law debt limit will be broached in April or May. Legislation could come up any time between now and then.

For more analysis of American economic policy, please visit my blog at KeithHennessey.com. If you like, you can subscribe at that site to my email mailing list.