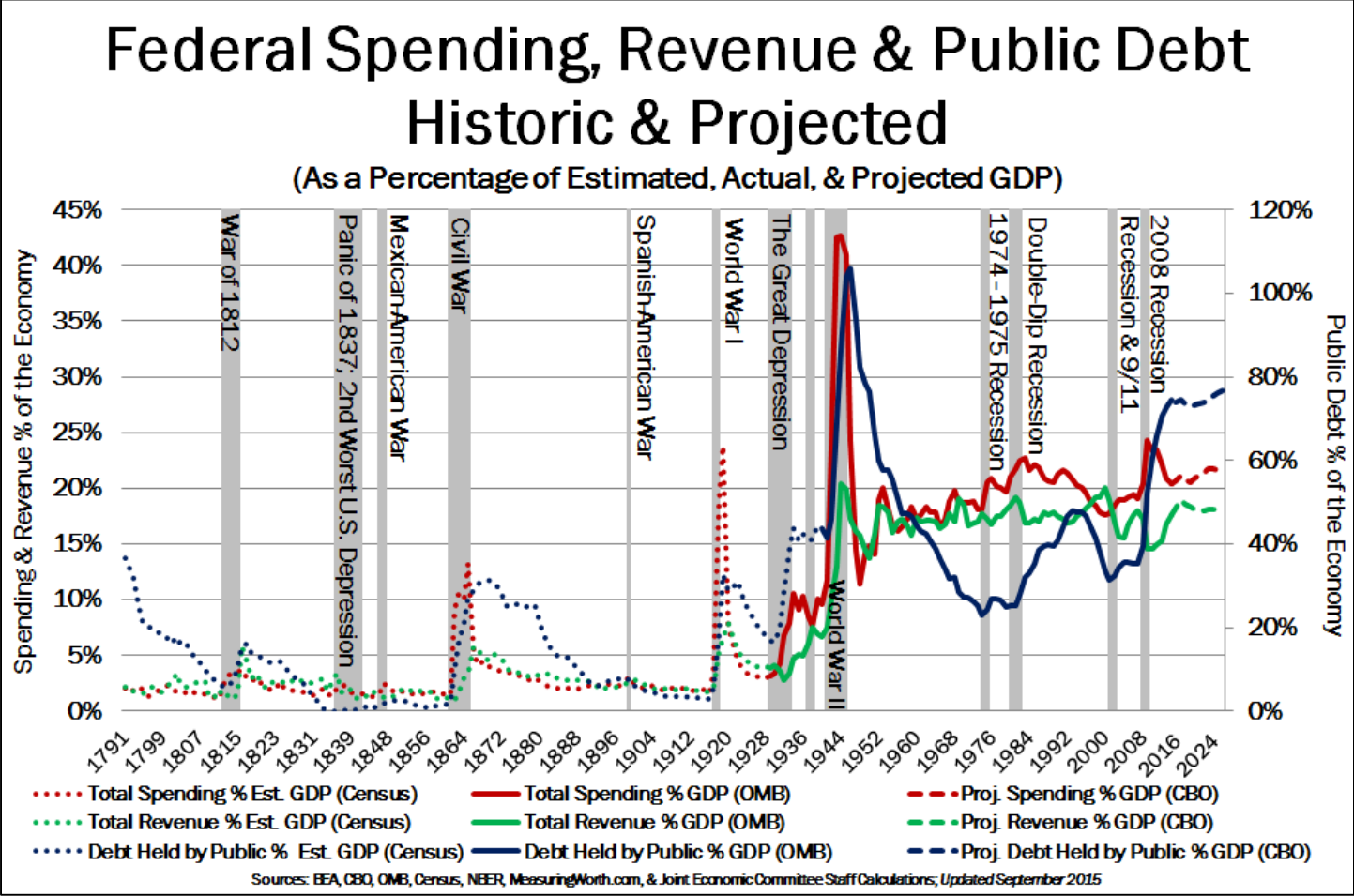


AN ECONOMIC HISTORY OF FEDERAL SPENDING & DEBT

*Economic Growth & Federal Budgeting Trends with Insights for the Future*

September 10, 2015



INTRODUCTION

In the realm of policy and politics, the need to focus on the present, and immediate future, can lead to a short historical memory. This is certainly true with respect to federal budgeting and debt.

Knowledge of budgeting and fiscal trends from twenty years ago, let alone prior to the 1974 Congressional Budget Act, is truly in short supply. Yet to

*To better understand and address the fiscal challenges of today, it is helpful to be informed and learn from past fiscal decisions, which are best illuminated in relation to the U.S. economy.*

***When viewed in relation to the size of the economy, an historical, incremental trend in federal spending is readily discernible in the United States—especially from the Woodrow Wilson Administration through the present.***

better understand and address the fiscal challenges of today, it is helpful to be informed and learn from past fiscal decisions, which are best illuminated in relation to the U.S. economy. Hence, this paper offers a side-by-side glimpse of U.S. economic growth and federal budgeting trends since our nation's founding, with special reference to the national debt, and tangential reference to the effect of federal regulations on the economy.

Though it is easy to be overwhelmed by the vastness of a \$3.5 trillion federal budget in FY2015, it is important to keep the principles of fiscal policy in context. Spending and budgeting decisions are a natural part of life. Whether it is the family budget or the federal budget, the general principles for sound decision-making remain the same. As the budget gets bigger, adherence to sound principles becomes even more important, as does the need to be aware of incrementalism, especially when spending decisions are on autopilot.

An example of an autopilot decision on a personal level occurs when we purchase gas for our vehicles. If the price is within a few cents of what we expect, we just fill up. Only if the gas price spikes by a dollar, do we disengage the autopilot to consider whether the spike is isolated to one station, meaning we will seek another station; or whether it is an economy-wide phenomenon, in which case we may decide to drive less or otherwise modify our routines.

Danger besets us when substantial spending is incrementally phased-in, such that it seems any single spending increase—viewed in isolation—is trivial. While failing to recognize and account for steady, incremental changes can wreak havoc on a family's budget; for the federal government—due to its sheer magnitude—staying on permanent autopilot can lead to economic harm and national fiscal ruin.

Unlike the family budget, which is typically viewed in current dollars, the federal budget needs to be examined with a different metric due to inflation over a much longer period of time. As such, it is best to evaluate the budget as a percentage of the nation's economy. The Bureau of Economic Analysis reports national Gross Domestic Product (GDP), but it is only reported since 1929. For years prior to 1929, measurements of GDP are estimates, and estimates in this paper draw from the work of academics published on the website [www.measuringworth.com](http://www.measuringworth.com).

When viewed in relation to the size of the economy, an historical, incremental trend in federal spending is readily discernible in the United States—especially from the Woodrow Wilson Administration through the present, with the periods of greatest acceleration occurring during the New Deal; the Great Society through the 1970s; and during the administrations of George W. Bush and Barack Obama. Worse yet, unsustainable, unreformed entitlement programs portend an even more ruinous fiscal future.

Since World War II, total federal outlays have averaged 19.26 percent of GDP. Many policymakers unquestioningly accept this spend-rate as appropriate. Yet, is such a high spend-rate in the nation's best interest? For instance, from

1791\* until the 1912 election of President Wilson, total federal spending averaged only 2.49 percent of estimated GDP.

Though a seismic shift in the role of government took place during the Wilson Administration, which makes comparisons between the two periods difficult, there still remains value in the examination. This study does not envision a return to spending under 3.0 percent of GDP—especially while entitlement spending (excluding interest outlays on the debt) alone is 12.20 percent of GDP, and defense spending is 3.47 percent of GDP—yet this study attempts to present federal spending in an historical context in order that policymakers may better understand the development of the federal spending system; grapple with the question of the appropriate size for the federal government; and consider what approach would be best—for economic growth and fiscal sustainability—to regulate federal spending going forward.

| POPULATION, GDP, AND FEDERAL REVENUE, SPENDING & DEBT AVERAGES BY PERIOD  |  |                   |   |  |   |  |  |                  |                  |
|---|--|-------------------|---|--|---|--|--|------------------|------------------|
| PERIOD  | HISTORICAL DEVELOPMENTS  | Population Growth | REAL ESTIMATED GDP & GDP GROWTH<br>Annual Average Growth Rate | TOTAL REVENUE<br>Annual Average as a % of Est. GDP / GDP | TOTAL SPENDING<br>Annual Average as a % of Est. GDP / GDP | NON-INTEREST SPENDING<br>Annual Average as a % of Est. GDP / GDP | PUBLIC DEBT<br>Annual Average as a % of Est. GDP / GDP | YEARS OF SURPLUS | YEARS OF DEFICIT |
| 1791-1816   | <b>Foundations: Power of the Purse</b><br>• Establishing the Power of the Purse<br>• House Committee on Ways and Means   | 110.97%           | 4.59%   | 2.13%  | 2.03%   | 1.30%  | 16.37%   | 17               | 9                |
| 1817-1865   | <b>Pre-Modern: Individual Appropriations</b><br>• Senate Committee on Finance<br>• Movement from Omnibus to Specialized Appropriations   | 300.25%           | 4.48%   | 2.11%  | 2.58%   | 2.33%  | 5.47%  | 30               | 19               |
| 1866-1920   | <b>Early-Modern: Deficiencies</b><br>• The Appropriations Committees<br>• Anti-Deficiency Acts of 1870 and 1905<br>• The Need for Budget Reform                                    | 195.30%           | 3.57%   | 3.09%  | 3.37%   | 2.81%  | 13.61%   | 38               | 47               |
| 1921-1974   | <b>Philosophical Shift</b><br>• Madison's Constitutionalism to Wilson's Progressivism<br>• The 1921 Budget Act & Power of the Purse<br>• Reforms in Congress and Executive Budgets | 97.07%            | 3.98%   | 12.19%   | 14.65%  | 13.48%   | 46.08%   | 18               | 36               |
| 1975-2000   | <b>Budgeting &amp; Fiscal Tools</b><br>• 1974 Budget Act & Budget Process<br>• 1985 Budget Act, Sequesters, and a Balanced Budget  | 30.75%            | 3.23%   | 17.83%   | 20.56%  | 18.03%   | 36.33%   | 3                | 23               |
| 2001-2014   | <b>Recent Budgeting</b><br>• A New Era of Big Government?<br>• A Turning of the Tide?  | 11.90%            | 1.79%   | 16.46%   | 20.47%  | 18.98%   | 48.27%   | 1                | 13               |
| Data from the transitional 6-month 1843 Fiscal Year; and the 1976 transition quarter are omitted.<br>Sources: U.S. Bureau of the Census <i>Historical Statistics of the United States from Colonial Times to 1970</i> ; OMB Historical Tables; www.MeasuringWorth.com; and Joint Economic Committee staff calculations. |  |                   |   |  |   |  |  |                  |                  |

\* Unless noted otherwise, data in this study begins with the year 1791. This is the first individual year, from which consistent reliable federal data is available going forward.

## Contents

|  |           |
|--|-----------|
| <b>PART 1: FEDERAL BUDGETING .....</b>                                 | <b>6</b>  |
| <b>1789 – 1816: Establishing the Power of the Purse .....</b>          | <b>6</b>  |
| <b>1817 – 1860: Growth in Individual Appropriations Bills.....</b>     | <b>8</b>  |
| <b>1861 – 1865: The Civil War .....</b>                                | <b>9</b>  |
| <b>1866 – 1920: Deficiencies and the Need for Spending Reform.....</b> | <b>10</b> |
| Deficiencies .....   | 10        |
| Spending Reform Efforts .....  | 11        |
| <i>Budget and Accounting Act of 1921 .....</i>                         | <i>13</i> |
| <b>1921 – 1974: The Great Philosophical Shift in Spending.....</b>     | <b>13</b> |
| Madison’s Constitutionalism to Wilson’s Progressivism .....            | 14        |
| Economic Effects of Spending Growth.....                               | 15        |
| Congressional Attempts to Reassert Authority.....                      | 17        |
| 1967 President’s Commission on Budget Concepts .....                   | 18        |
| <i>Congressional Budget &amp; Impoundment Control Act of 1974.....</i> | <i>19</i> |
| <b>1975 – 2000: Budgeting &amp; Fiscal Tools .....</b>                 | <b>20</b> |
| Use of the Reconciliation Process .....                                | 21        |
| The Focus on Deficits—Gramm-Rudman & Sequesters .....                  | 22        |
| How the Budget Was Balanced: Spending Restraint & Growth.....          | 23        |
| <b>Recent Budgeting: 2001 – 2015 .....</b>                             | <b>25</b> |
| <b>A New Era of Big Government (2001 – 2010) .....</b>                 | <b>25</b> |
| <b>2011 — A Turning of the Tide? .....</b>                             | <b>26</b> |
| <b>The Task Ahead: Restraining Spending in an Enduring Way.....</b>    | <b>27</b> |
| Focus on What Congress Can Control—Primary Spending .....              | 29        |
| Use a Stable Base for a Spending Cap—Potential GDP.....                | 29        |
| A Spending Level That Does Not Harm Job Creation & Growth .....        | 30        |
| <b>PART 2: THE FEDERAL DEBT &amp; THE DEBT CEILING.....</b>            | <b>32</b> |
| <b>A Change in the Approach to Debt .....</b>                          | <b>32</b> |
| <b>What Constitutes the Debt Subject to the Debt Limit.....</b>        | <b>32</b> |
| <b>Debt Limit History .....</b>  | <b>33</b> |
| The Debt Limit Prior to 1939.....                                      | 33        |
| World War I to 1939.....   | 34        |
| The Post-War Statutory Debt Limit.....                                 | 35        |
| The 1953 Debt Crisis .....   | 35        |

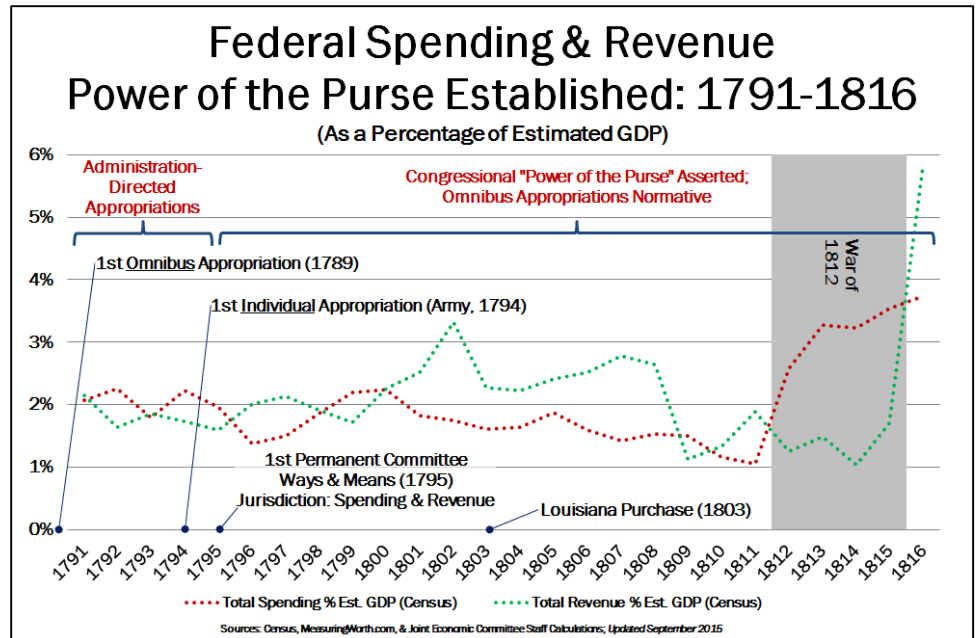


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|---|-----------|
| The Debt Limit Since 1980.....                          | 35        |
| Using the Debt Limit to Affect Budgeting .....          | 36        |
| <b>IN BRIEF: THE TRUE “OFF-BUDGET”—REGULATIONS.....</b> | <b>37</b> |
| <b>CONCLUSION .....</b>                                 | <b>38</b> |
| <b>ENDNOTES .....</b>                                   | <b>39</b> |

| POPULATION, GDP, AND FEDERAL REVENUE, SPENDING & DEBT AVERAGES BY DECADE  |                   |   |  |   |  |  |                  |                  |
|---|-------------------|---|--|---|--|--|------------------|------------------|
| DECADE  | Population Growth | REAL ESTIMATED GDP & GDP GROWTH<br>Annual Average Growth Rate | TOTAL REVENUE<br>Annual Average as a % of Est. GDP / GDP | TOTAL SPENDING<br>Annual Average as a % of Est. GDP / GDP | NON-INTEREST SPENDING<br>Annual Average as a % of Est. GDP / GDP | PUBLIC DEBT<br>Annual Average as a % of Est. GDP / GDP | YEARS OF SURPLUS | YEARS OF DEFICIT |
| 1790s   | 34.82%            | 6.31%   | 1.90%  | 1.95%   | 1.01%  | 24.33%   | 6                | 4                |
| 1800s   | 32.28%            | 3.71%   | 2.32%  | 1.59%   | 0.93%  | 13.07%   | 9                | 1                |
| 1810s   | 29.34%            | 3.11%   | 2.63%  | 2.85%   | 2.24%  | 10.78%   | 5                | 5                |
| 1820s   | 30.33%            | 4.41%   | 2.57%  | 1.93%   | 1.44%  | 9.40%  | 8                | 2                |
| 1830s   | 28.94%            | 3.59%   | 2.27%  | 1.76%   | 1.73%  | 0.80%  | 7                | 3                |
| 1840s   | 32.07%            | 4.95%   | 1.44%  | 1.68%   | 1.60%  | 1.46%  | 4                | 5                |
| 1850s   | 30.79%            | 5.39%   | 1.66%  | 1.63%   | 1.55%  | 1.43%  | 7                | 3                |
| 1860s   | 23.87%            | 3.13%   | 3.62%  | 6.64%   | 5.63%  | 22.98%   | 5                | 5                |
| 1870s   | 22.56%            | 5.28%   | 3.67%  | 3.19%   | 1.94%  | 25.57%   | 10               | 0                |
| 1880s   | 22.52%            | 5.21%   | 2.94%  | 2.12%   | 1.69%  | 12.55%   | 10               | 0                |
| 1890s   | 18.10%            | 3.27%   | 2.36%  | 2.46%   | 2.22%  | 6.91%  | 4                | 6                |
| 1900s   | 19.11%            | 2.49%   | 2.12%  | 2.08%   | 1.99%  | 4.18%  | 5                | 5                |
| 1910s   | 13.42%            | 2.72%   | 3.30%  | 6.46%   | 6.19%  | 10.40%   | 4                | 6                |
| 1920s   | 13.50%            | 3.14%   | 4.56%  | 3.67%   | 2.70%  | 22.65%   | 10               | 0                |
| 1930s   | 6.52%             | 2.12%   | 5.19%  | 8.47%   | 8.73%  | 38.41%   | 0                | 10               |
| 1940s   | 14.14%            | 5.96%   | 14.82%   | 24.08%  | 22.75%   | 78.41%   | 3                | 7                |
| 1950s   | 16.65%            | 3.91%   | 17.08%   | 17.35%  | 16.10%   | 53.35%   | 4                | 6                |
| 1960s   | 11.63%            | 4.40%   | 17.35%   | 18.15%  | 16.91%   | 35.48%   | 1                | 9                |
| 1970s   | 9.42%             | 3.21%   | 17.37%   | 19.61%  | 18.13%   | 25.66%   | 0                | 10               |
| 1980s   | 8.72%             | 3.24%   | 17.65%   | 21.59%  | 18.78%   | 35.14%   | 0                | 10               |
| 1990s   | 111.90%           | 3.34%   | 18.17%   | 19.65%  | 16.82%   | 43.80%   | 3                | 7                |
| 2000s   | 8.70%             | 1.73%   | 16.57%   | 19.97%  | 18.44%   | 39.26%   | 1                | 9                |
| 2010s   | 2.24%             | 1.95%   | 16.17%   | 21.71%  | 20.33%   | 70.81%   | 0                | 4                |
| Data from the transitional 6-month 1843 Fiscal Year; and the 1976 transition quarter are omitted.   |                   |   |  |   |  |  |                  |                  |
| For 1790s through 1920s, estimated GDP is obtained from <a href="http://www.measuringworth.com">www.measuringworth.com</a>  |                   |   |  |   |  |  |                  |                  |
| Sources: U.S. Bureau of the Census <i>Historical Statistics of the United States from Colonial Times to 1970</i> ; OMB <i>Historical Tables</i> ; <a href="http://www.Measuringworth.com">www.Measuringworth.com</a> ; and Joint Economic Committee staff calculations. |                   |   |  |   |  |  |                  |                  |

## PART 1: FEDERAL BUDGETING

### 1789 – 1816: Establishing the Power of the Purse



The power and authority of Congress to expend the people’s money is found in the Constitution, where Article I, Section 9, Clause 7 declares that, ***“No money shall be drawn from the treasury, but in consequence of appropriations made by law, and a regular statement and account of receipts and expenditures of all public money shall be published from time to time.”*** Of this power, Constitutional advocate—and future President—James Madison wrote in the 58<sup>th</sup> Federalist Paper, between the Constitution’s adoption on September 17, 1787 and its formal ratification:

***How exactly this “power of the purse” was to be exercised by the new Congress in the fledgling nation would be determined by the early precedents set by the first few Congresses.***

***The House of Representatives cannot only refuse, but they alone can propose, the supplies requisite for the support of government. They, in a word, hold the purse ... This power over the purse may, in fact, be regarded as the most complete and effectual weapon with which any constitution can arm the immediate representatives of the people, for obtaining a redress of every grievance, and for carrying into effect every just and salutary measure.***<sup>1</sup>

How exactly this **“power of the purse”** was to be exercised by the new Congress in the fledgling nation would be determined by the early precedents set by the first few Congresses. Though the House **Committee on Ways and Means**, which was first created in July 1789, would become the preeminent appropriations committee through the Civil War (along with the Senate Finance Committee), the House Committee did not come into permanent existence until the 4<sup>th</sup> Congress.<sup>2</sup>

Over the first few Congresses, the House operated closely with Treasury Secretary **Alexander Hamilton** in preparing what could be considered the early federal budgets. Administration officers would submit estimates of revenue and expenditures to the House, which would approve the figures or request revisions from the executive departments. When the figures were acceptable, they were drafted into an appropriations bill for consideration by both House and Senate, and upon approval would be sent to President George Washington to be signed into law.<sup>3</sup> The first appropriations bill in 1789, which funded the whole of the federal government (an “omnibus” bill)—totaled \$639,000\* and took up a mere 13 printed lines.<sup>4</sup>

Notwithstanding the commendable performance of Hamilton, many in Congress believed that too much of the congressional power of the purse was being inappropriately delegated to the executive branch. Thus, a balancing of power can be seen with the permanent establishment of the Ways and Means Committee in the 4<sup>th</sup> Congress. With Hamilton’s departure from Washington’s cabinet in 1795 and through the Adams and Jefferson Administrations, the legislative branch began to further assert its Constitutional duty of guiding the nation’s spending. Through the 1790s, annual estimated real GDP<sup>†</sup> grew at 6.31 percent, and annual federal outlays totaled a mere 1.95 percent of the economy.

During President **Thomas Jefferson’s** Administration (1801 – 1809), Ways and Means continued compiling the federal budget, utilizing three categories: (1) the civil list and general administrative costs; (2) military expenditures; and (3) foreign affairs. The committee would normally present an annual report to Congress in January.<sup>5</sup>

Another example of the legislature wielding its power of the purse in the first decade of the 19<sup>th</sup> century came in the formula for appropriations. Whereas the formula had previously included the singular “sum” appropriated—implying a lump sum for a whole appropriations bill—after 1804, the general formula included the plural “sums” appropriated,<sup>6</sup> which had the effect of increasing congressional power in directing funds within the specific areas being funded through the omnibus appropriations bills.

Amazingly, despite the 1803 **Louisiana Purchase** doubling the size of the United States, total federal spending in the first decade of the 19<sup>th</sup> century averaged just 1.59 percent of estimated GDP—nearly a quarter percent less than it did in the 1790s. During the Madison Administration, the power of Ways and Means steadily increased, and though there had been some movement away from “omnibus” appropriations bills—beginning with

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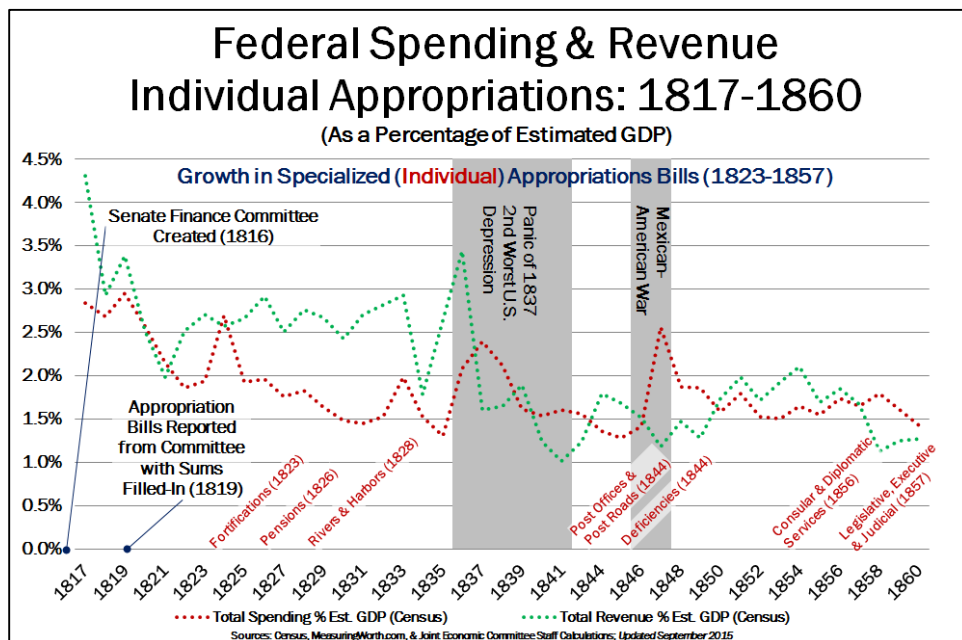
\* \$639,000 in 1789 is roughly equivalent to \$17.7 million in 2015.

† The Bureau of Economic Analysis (BEA) provides data on U.S. Gross Domestic Product (GDP) since 1929. Estimates of the size of the U.S. economy and GDP prior to 1929—referred to in this report as estimated GDP—are obtained from Louis Johnston and Samuel H. Williamson, “What Was the U.S. GDP Then?” Measuring Worth. Their full data set is available at: <http://www.measuringworth.org/usgdp/>

separate bills for the Army (1794) and Navy (1799)—during this foundational period, appropriations measures remained largely consolidated.

So, from the Washington Administration through the Madison Administration (1791 – 1816), total federal spending—which included the Louisiana Purchase and funding for the **War of 1812**—only averaged 2.03 percent of estimated GDP. Meanwhile, real economic growth averaged 4.59 percent; and the nation’s population more than doubled.

### 1817 – 1860: Growth in Individual Appropriations Bills



***The Senate had no standing committees throughout its first 27 years. Then, in December 1816—in the 14<sup>th</sup> Congress—the Senate established the Finance Committee, which joined the House Ways and Means Committee in the fields of revenue and appropriations.***

Unlike the House, the smaller Senate had no standing committees throughout its first 27 years. Then, in December 1816—in the 14<sup>th</sup> Congress—the Senate established the **Finance Committee**, which joined the House Ways and Means Committee in the fields of revenue and appropriations.<sup>7</sup> These committees held great sway in the national legislature. *The Bicentennial History of the Committee on Ways and Means* comments:

*By 1819, the committee’s control over appropriations was such that the chairman, [William] Lowndes, could report an appropriations bill with the blanks filled in. It had been the custom for the committee to report the various items without stating specific amounts. The amounts would be supplied following debate in the Committee of the Whole House. Lowndes argued that his committee, having examined and revised the executive department estimates, was justified in reporting specific sums. The House, he concluded, could change any figure that they deemed necessary or extravagant.<sup>8</sup>*

Thereafter, this became standard practice. The 1820s also began an era of greater **specialization in federal appropriations**. From the nation’s founding through the early 1820s—though federal spending as a percentage of the economy remained constant and small—in nominal terms, total federal



spending tripled. This growth in scale no doubt contributed toward a growth in specialization for appropriations. Whereas there had previously been separate funding bills for the Army and Navy, this trend of specialization gained momentum.

Separate appropriations bills for **fortifications** (1823), **pensions** (1826), and **rivers and harbors** (1828) were passed in the nation's fourth decade; **post offices and post roads** (1844), **deficiencies** (1844), **consular and diplomatic services** (1856), and **legislative, executive, and judicial expenses** (1857) followed.<sup>9</sup> Some of these more specific bills were handled in a decentralized fashion by other committees. Rivers and harbors, for instance, was handled by the Committee on Commerce,<sup>10</sup> and jurisdiction for some of the other specialized appropriations bills was passed back-and-forth: While Army was handled by Finance from the new committee's creation, Naval appropriations "continued to be handled by the Committee on Naval Affairs until 1827 (with the exception of the two years 1821 and 1822)."<sup>11</sup>

Total federal spending as a percent of estimated GDP averaged 1.93 percent in 1820s; 1.76 percent in the 1830s—even with the nation's second deepest depression, which was brought about by the policies of President Andrew Jackson;<sup>12</sup> 1.68 percent in the 1840s—including funding for the Mexican-American War; and 1.63 percent in the 1850s. Estimated annual real GDP growth from the Madison Administration to the onset of the Civil War averaged 4.43 percent, while the population grew by about 300 percent.

## **1861 – 1865: The Civil War**

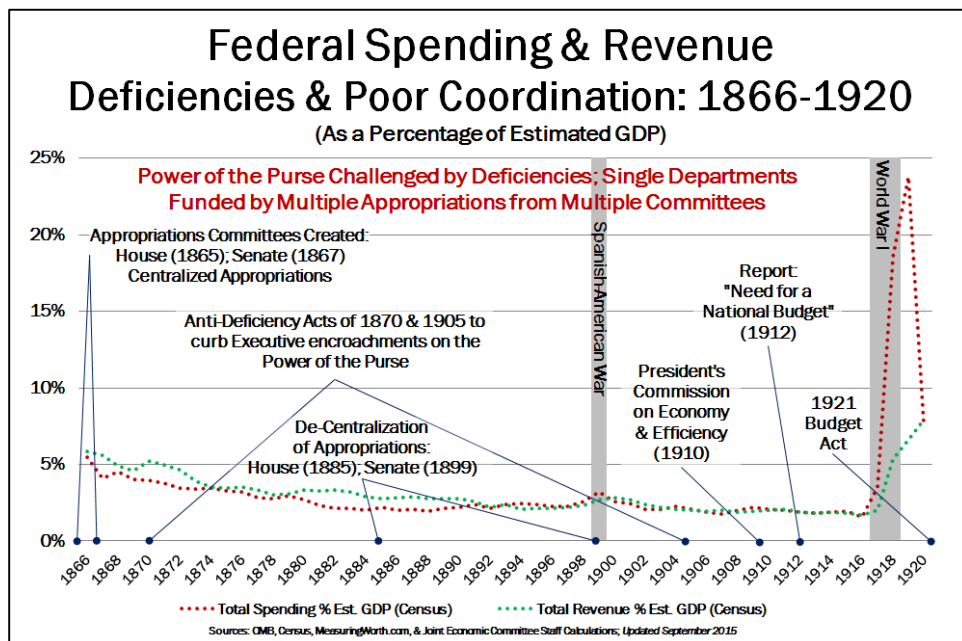
Federal spending during the **American Civil War** soared beyond anything in the nation's prior history. Whereas the previous peak for total federal spending as a percentage of the economy was reached in 1816 at 3.73 percent, total federal spending during the Civil War peaked at 13.29 percent of estimated GDP in FY1865. Yet beyond the Civil War's cost to America in terms of lives lost and people maimed, and even beyond the war's profound social, political, and national effects, the war also forced a shift in responsibility for federal spending.

Prior to and during the war, the responsibilities of the Ways and Means and Finance Committees included both revenue and appropriations. However, the magnitude and scope of these two most important functions proved in practice to be too heavy of a burden for a single committee and single chairman to handle. This became readily apparent during the war; so after the war, jurisdiction of the Ways and Means and Finance Committees was split. Ways and Means and Finance would retain their revenue responsibilities, but new **Appropriations Committees** were created in each chamber to oversee federal spending thereafter.\*

*Growth in the scale of federal spending contributed toward a growth in specialization for appropriations.*

*After the Civil War, jurisdiction of the Ways and Means and Finance Committees was split. Ways and Means and Finance would retain their revenue responsibilities, but new Appropriations Committees were created.*

\* Also split from the jurisdiction of Ways and Means and Finance Committees at this time was responsibility for Banking and Financial Services.

**1866 – 1920:****Deficiencies and the Need for Spending Reform**

Congressional authority over the power of the purse was well-established by the time that the **House (1865) and Senate (1867) Appropriations Committees** were chartered, with the centralization of appropriations within the committees. Meanwhile, total federal spending, which peaked during the Civil War at 13.29 percent of the economy, tapered back to a more normative 2.58 percent of estimated GDP during the period between the creation of the Appropriations Committees and the onset of American involvement in World War I—or 3.37 percent of estimated GDP if the period is extended through World War I to the *1921 Congressional Budget Act*.

**Deficiencies**

As the regular appropriations process moved forward, greater emphasis was placed upon rooting out executive challenges to the power of the purse, and upon fine-tuning of the spending system.

Executive challenges to the power of the purse came in the form of **deficiencies**—a topic that remains relevant in the 21<sup>st</sup> century: Can the federal government, in an emergency, expend resources toward an end, to which Congress has yet to appropriate funds; or, more generally, can the government expend resources or make contractual commitments beyond what Congress has appropriated?

President Jefferson faced the emergency question in the wake of the **1807 Chesapeake Affair**, in which the British attacked an American warship, and Jefferson—anticipating the possibility of war—directed the purchase of military supplies in excess of amounts appropriated by Congress. Jefferson's

*Executive challenges to the power of the purse came in the form of deficiencies. ... Can the federal government expend resources toward an end, to which Congress has yet to appropriate funds?*

anxieties were no doubt assuaged by the strong anti-British sentiment at the time and the confidence that Congress would fully support his actions.<sup>13</sup>

Some wiggle-room may be afforded in a crisis, but the greater threat is to be found in the more common-place actions. These non-emergency deficiencies were the focus of the anti-deficiency legislation of the 1870s and early 1900s.

While Congress first enacted a law to prohibit federal spending in excess of appropriations in 1820, that early prohibition only applied to the Secretaries of State and Treasury, and the Departments of War and the Navy.<sup>14</sup> It did not apply to other departments and agencies—hence, the aforementioned deficiency appropriations beginning in 1844. A common executive abuse at this time was “the borrowing of funds by federal agencies (without legislative permission) in anticipation of future appropriations,”<sup>15</sup> which had the effect of undermining Congress’s power of the purse. The **1870 Anti-Deficiency Act** extended the 1820 prohibition to all federal agencies; and to this law, criminal penalties were added in the **1905 Anti-Deficiency Act**. Nonetheless, even with these laws, deficiencies continued to be an issue—as one senator from the period noted: “no one had been punished under the provisions of the Anti-Deficiency Act.”<sup>16</sup>

During these five decades (1870s through 1910s), total federal spending as a percent of estimated GDP averaged 3.19 percent in the 1870s; 2.12 percent in the 1880s; 2.46 percent in the 1890s; 2.08 percent in the first decade of the 20<sup>th</sup> century; and 6.46 percent in the 1910s—a percentage primarily boosted by American involvement in the First World War, and to a lesser extent by Wilsonian policies.

## Spending Reform Efforts

A further word is in order with respect to the nominal growth of federal spending, and the broader movement toward **reforming federal budgeting**—a movement whose emergence preceded the administration of President Woodrow Wilson (1913 – 1921).

In a **1908 Report**, President **Theodore Roosevelt**’s Secretary of the Treasury, **George Cortelyou** expressed alarm at the tremendous increase in non-interest federal spending over the preceding 30 years. Though Cortelyou was looking at nominal spending rather than spending as a percentage of the economy [the primary focus of this study], his sounding of the alarm is still worth noting as it relates to the eventual adoption of the *Budget and Accounting Act of 1921*.<sup>17</sup>

Over the preceding 30-year period (1878 – 1908), upon which Cortelyou focused, nominal spending had nearly tripled, and non-interest spending—on which Cortelyou rightly focused as a better measure to evaluate spending for policy-making purposes—had more than quadrupled. Where his analysis fell short was in failing to compare spending growth with the economic growth of the nation. Had he taken his critique further, he would have observed that the economy had increased by an amount roughly equivalent to the growth in

*A common executive abuse at this time was “the borrowing of funds by federal agencies (without legislative permission) in anticipation of future appropriations,” which had the effect of undermining Congress’s power of the purse.*

*Over the preceding 30-year period ... nominal spending had nearly tripled, and non-interest spending ... had more than quadrupled. Where his analysis fell short was in failing to compare spending growth with the economic growth of the nation.*

*Each department prepared its own appropriations request, which was transmitted to Congress without modification and considered without reference to other appropriations requests.*

*Decentralized appropriations only made budgeting more difficult. Eight different committees were handling appropriations, and “appropriations for a single department might be handled by several different committees.”*

nominal spending for the period. Over this period, as a percentage of the economy, total federal spending (including interest) averaged 2.29 percent, and this average drops to 1.93 percent if one just looks at non-interest federal spending.

Nonetheless, the 1908 Report helped to underscore the **weaknesses of federal budgeting** during the period—a period when each department prepared its own appropriations request, which was transmitted to Congress without modification and considered without reference to other appropriations requests. As government grew—even in proportion to the economy—a situation presented where Congress did not even know “how much money would be actually spent during the year, how much might be spent under appropriations previously enacted, and whether or not the revenues for the year would be sufficient to cover the expenditures.”<sup>18</sup>

Beyond the scatter-shot communications between the various departments interacting with Congress, a **return to decentralized appropriations** also contributing to the weakness in federal budgeting. By 1885, the House Appropriations Committee retained jurisdiction over only 6 of the 14 general appropriations bills; the Senate followed suit by 1899 with the Senate Appropriations Committee likewise retaining jurisdiction over only 6 bills.<sup>19</sup> While the Appropriations Committees had served to strengthen the congressional power of the purse by itemizing appropriations and restricting the administration’s power to transfer funds, it also had become very powerful in relation to other committees. Hence, the move toward decentralization in appropriations was certainly presaged by the growth in power of the Appropriations Committees.<sup>20</sup> Yet, this decentralization only made budgeting more difficult. Eight different committees were handling appropriations, and “appropriations for a single department might be handled by several different committees. As an extreme example, appropriations for the War Department were handled in four different bills before three separate committees.”<sup>21</sup>

The task of moving forward with budget reform fell to Roosevelt’s successors. In 1910, President **William Howard Taft** sought authority and funding, which was granted by Congress, to create a **President’s Commission on Economy and Efficiency** to examine federal budgeting. In June 1912, the commission issued its report on the “**Need for a National Budget.**” The budget system envisioned by the commission would give the president responsibility for preparation and execution of the budget, while Congress’s role was merely to revise and enact the budget.<sup>22</sup>

Whether due to the affront to the congressional power of the purse—by giving Congress a seemingly backseat role in directing federal spending—or due to the further effrontery of President Taft—by requesting that executive departments and agencies prepare their appropriations requests to Congress both according to their standard practice and also according to the Commission’s recommendations—Congress allowed the question of budget reform to languish for two more presidential terms.

Finally, in 1919 Congress established select committees to hold hearings and make recommendations for budget reforms. The recommendations were drafted into legislation and passed overwhelmingly by both House and Senate in 1920, though President Wilson vetoed the bill “because of concern with the constitutionality of a provision involving his removal power over the new office of Comptroller General.”<sup>23</sup> Following the election of President **Warren Harding**, the bill was again passed, with minor changes, and signed into law in early 1921.

### ***Budget and Accounting Act of 1921***

The ***Budget and Accounting Act of 1921*** provided much of the framework for the budgeting system that is in place today—though with substantial amendments in subsequent years. The law’s three main contributions were the creation of:

- (1) A legal obligation for the President to submit a single, **consolidated budget proposal** for congressional consideration each year;
- (2) The **Bureau of the Budget** (later renamed the **Office of Management and Budget**) to provide the President with resources necessary to produce the annual budget proposal; and
- (3) The **General Accounting Office** to provide Congress with the resources to ensure accountability.

From President Andrew Johnson’s Administration through the Wilson Administration (1865 – 1920), total federal spending—including expenses related to World War I—averaged 3.37 percent of estimated GDP. Estimated real GDP grew at an average annual pace of 3.57 percent; and the nation’s population roughly tripled—growing from 36 million to 106 million.

## **1921 – 1974: The Great Philosophical Shift in Spending**

A progressive philosophical shift in federal spending began under President **Woodrow Wilson**. The First World War masked the fiscal effect of Wilson’s policies, but a clear change had occurred between pre- and post-war federal spending. Whether viewed as total spending or isolated to non-interest spending, federal spending as a percentage of the economy had notably increased. For the 10 years prior to Wilson (1902 – 1912), non-interest federal spending averaged 1.95 percent of the economy; for the 10 years after Wilson (1921 – 1931), it averaged 2.77 percent.\* Yet due to the Great War’s effect on spending, it is better to study the effects of the philosophical shift with the enactment of the *1921 Budget Act*, rather than with the inauguration of Wilson.

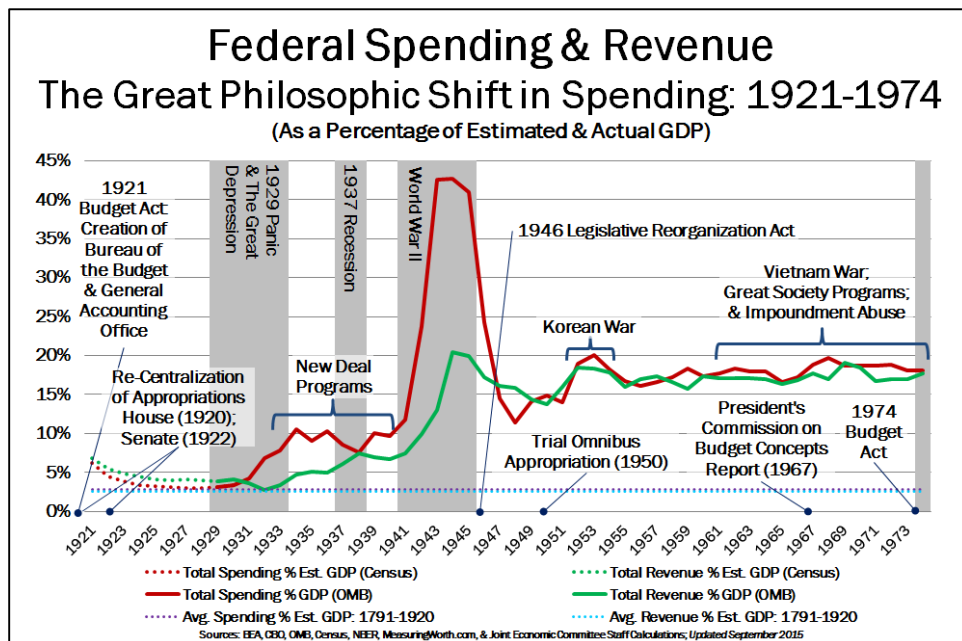
***The Budget and Accounting Act of 1921 provided much of the framework for the budgeting system that is in place today.***

***The First World War masked the fiscal effect of Wilson’s policies, but a clear change had occurred between pre- and post-war federal spending.***

\* Total federal spending (including the costs to service the nation’s debt from World War I) rose from an average of 2.03 percent (1902 - 1912) to 3.72 percent of the economy (1921 – 1931).



*From 1791 through 1920, the spending pendulum swung back and forth from centralized to decentralized appropriations in the Congress. Following the 1921 Budget Act, the pendulum travelled from the Congress to the executive domain. The pendulum has not yet returned with Congress exerting the same level of spending control.*



## Madison's Constitutionalism to Wilson's Progressivism

From the nation's founding through 1920, total federal spending as a percentage of the economy (including the Civil War) averaged 2.80 percent; but since then (1921 – 2014), total federal spending has risen to an average of 17.27 percent. George Will—writing on Wilson's underlying philosophy—succinctly contrasted Wilson with James Madison by noting, “Wilsonian government, meaning (in Wilson's words) government with ‘unstinted power,’ is hostile to Madison's Constitution, which, Madison said, obliges government ‘to control itself.’”<sup>24</sup>

The combination of philosophical change, along with the new budget process—which gave the President a more prominent role in directing federal spending, as well as expanding “the President’s control over budgetary information by establishing the Bureau of the Budget,”<sup>25</sup>—were two of the notable forces at work as federal spending began to deviate from the historical average rate.

If federal spending and budgeting are thought of as a pendulum, from 1791 through 1920, the pendulum swung back and forth from centralized to decentralized appropriations in the Congress. Following the *1921 Budget Act*, appropriations were fixed in a centralized fashion with the pendulum subsequently traveling on a new, perpendicular course from the Congress to the executive domain. Though the pendulum has in some ways moved back toward the legislative domain (with the enactment of a series of spending reform tools), it should be added that the pendulum has not yet returned to its previous orbit with Congress exerting the same level of spending control as it did prior to the 1921 reform.

Certainly, this philosophical shift was a product of the era, and it was bipartisan. From the 67<sup>th</sup> through the 71<sup>st</sup> Congresses (1921 - 1931)—a

period during which the spending expansion began, albeit only in a small way—Republican Presidents Harding, Coolidge and Hoover headed the executive; Republicans held an uninterrupted Senate majority (averaging 54 of 96 seats); and Republicans held an uninterrupted House majority (averaging 256 of 435 seats). The median for primary (non-interest) federal spending in the decade prior to the *1921 Budget Act* had been 1.93 percent of estimated GDP, while in the decade after the *Act*, the median for primary outlays (excluding World War I debt costs) was 2.35 percent.

During the last year of the Hoover Administration (1932), with the economy plunging from recession toward depression, total federal spending as a percentage of the economy more than quadrupled from its FY1916 (pre-World War I) level of 1.60 percent of estimated GDP to 6.81 percent of GDP. Outside of the Civil War and the First World War, the federal spend-rate had never been higher as a percentage of the economy.

On balance, empirical research provides little support for the contention that President Franklin D. Roosevelt's Keynesian policies helped to pull the United States out of the Great Depression. However, the circumstances did allow the administration to pursue many progressive policies and spending initiatives. Perhaps it was in thinking about this period that led former Presidential Chief of Staff Rahm Emanuel to express to the *Wall Street Journal* in a post-election 2008 meeting that, "You never want a serious crisis to go to waste. ... This [2008] crisis provides the opportunity for us to do things that you could not do before."<sup>26</sup>

As a percentage of the economy, from when Roosevelt took office through FY1941—the last fiscal year\* before the U.S. entered World War II—federal spending as a percentage of the economy averaged 9.50 percent, growing from 7.88 percent in FY1933 to 11.75 percent in FY1941.

### Economic Effects of Spending Growth

The broader economic and social value of this growth in federal spending as a percentage of the economy deserves closer examination. The House Committee on Appropriations' website currently observes, "By 1940, spending in appropriations bills had climbed to \$14.6 billion as a result mainly of various New Deal legislation—when we began meeting local problems with national programs."<sup>27</sup> Yet, what are the costs and benefits of the resulting growth in federal spending?

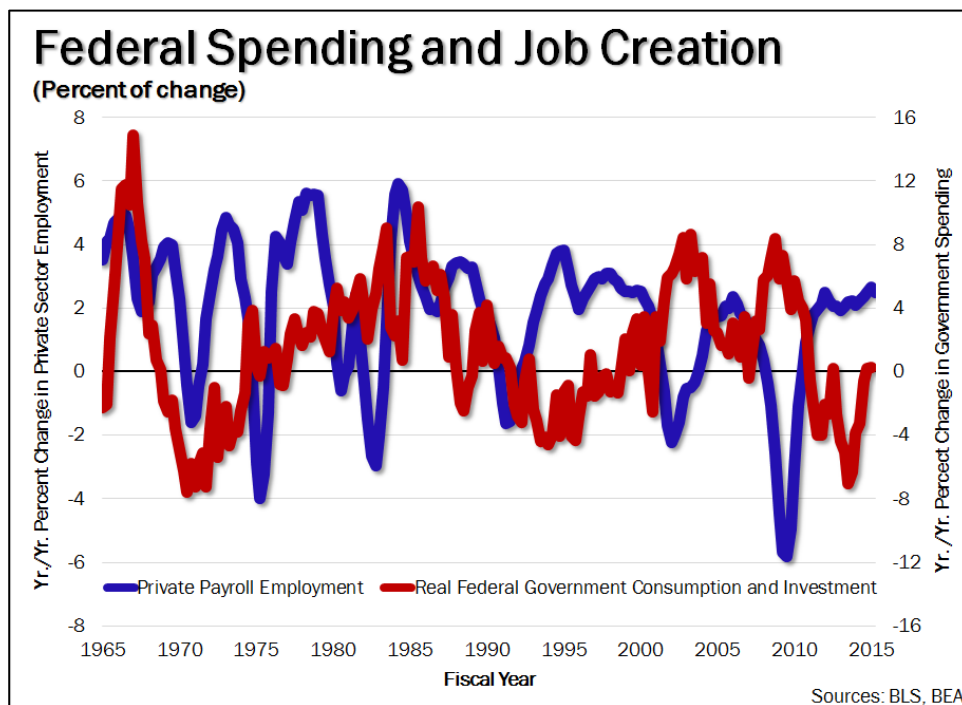
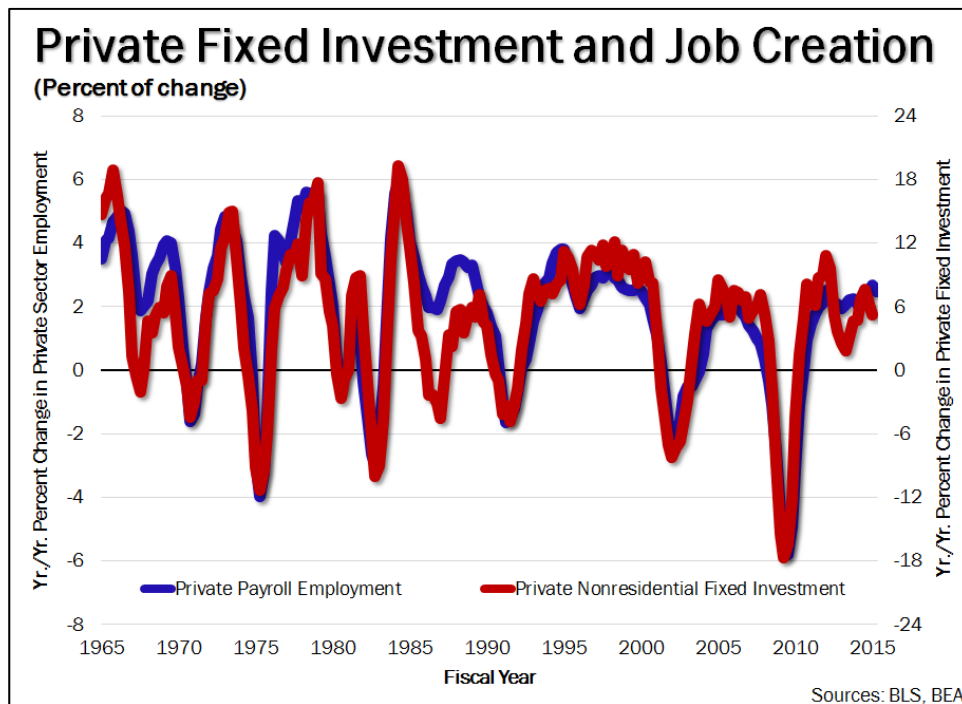
While more spending and a bigger federal government can mean more federal jobs, these jobs come at the expense of private sector resources, meaning fewer private sector jobs and lost economic opportunities. Hence, more federal spending does not automatically equate to an increase in wealth and output. Moreover, when examining the relationship between

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\* From 1844 through 1976, U.S. government fiscal years ran from July through June, so the 1941 fiscal year ended nearly six months prior to the U.S. entering World War II.

private sector business investment and private payroll employment, one finds a very close relationship; whereas there is an inverse relationship between federal spending and private payroll employment.\*

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This inverse relationship between increased spending and private sector job creation does not mean that private sector employers stop hiring simply because the government is spending more. In fact, the government may

\* The correlation between private fixed investment and private sector job creation is very strong—0.88—whereas there is little correlation between federal spending and private sector job creation.

spend more on programs like unemployment insurance because private sector employers are not hiring. Yet, one of the keys for an increase in private sector business investment is the private sector's anticipation of future costs, including taxes. If the private sector sees the government spending more, it may slow or reluctantly make investment and hiring decisions in order to weather the coming higher taxes that will be necessary to pay for current government spending. Conversely, as the private sector anticipates lower future costs, including lower taxes, private investment increases, which leads to more jobs. Hence, there is a close relationship between private sector investment and private sector jobs; and the reduced government spending can help to spur private sector investment.

### **Congressional Attempts to Reassert Authority**

The FDR Administration clearly drove federal spending during the New Deal, but Congress—which from the 73<sup>rd</sup> through the 79<sup>th</sup> Congresses (1933 – 1946) was controlled by Democrats (Democrats averaged 65 of 96 Senate seats, 68 percent; and 280 of 435 House seats, 64 percent)—acquiesced to the spending with their support of the Administration and its policies.

Nevertheless, there was a growing awareness that Congress had ceded too much of its power of the purse to the executive branch. While there were no serious attempts to pare back the increased scale and scope of federal spending as a percentage of the economy, two measures enacted in 1946 represented an attempt by Congress to reassert its authority over spending, and to approach federal budgeting in a more responsible manner: *The Legislative Reorganization Act of 1946* and *The Employment Act of 1946*.

First, in addition to reorganizing congressional committees (i.e., consolidating and reducing their number and providing more resources for the remaining committees to function), the **1946 Legislative Reorganization Act** also provided for a “super-committee”—the **Joint Committee on the Legislative Budget**, consisting of members from the Appropriations, Ways and Means, and Finance Committees—to meet and produce a legislative budget at the beginning of each congressional session. In 1947, agreement on a budget between the Chambers could not be reached; in 1948, agreement was reached though the Congress did not adhere to it; and in 1949, agreement was again elusive. Though the process was abandoned thereafter (and officially repealed in 1970),<sup>28</sup> it did mark a serious attempt to improve federal budgeting.

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*In 1950—hearkening back to the early days of the Republic, or perhaps foreshadowing government funding in recent years—the Appropriations Committees produced a single Omnibus Appropriations Act for FY1951. The Act was passed, but it was adopted late. Thereafter, the House and Senate reverted to individual appropriations measures.*

*By the 1960s, budgets from the executive branch were presented in various forms that were often opaque and confusing to the public, the media, and even policymakers.*

Next, the **1946 Employment Act** established the **Joint Economic Committee (JEC)** and the **President’s Council of Economic Advisers (CEA)**. With respect to the overall budget framework and trajectory, to this day, the JEC enhances the legislative and budget process by serving as an internal Congressional think-tank, which provides a serious and credible platform to broadly examine developments in the U.S. economy, and by advising Congress on the economic ramifications of policies being contemplated and considered. Of special note, among its contributions, the JEC helped to lay the intellectual groundwork for the Kennedy tax cut in 1964 and later for the Reagan tax cuts in the 1980s. With its 1980 report *“Plugging in the Supply Side,”* which was unanimously supported by all Democrats and Republicans, the JEC played a major role in establishing the credibility of supply-side economics, thereby paving the way for subsequent enactment of pro-growth tax policies, favoring lower marginal rates and lower rates of taxation on capital income. Data clearly demonstrates that lowering the cost of capital for new business investment is pivotal for driving private sector economic growth and job creation.

Further experimentation with reforms followed the 1946 efforts. In 1950—hearkening back to the early days of the Republic, or perhaps foreshadowing government funding in recent years—the House and Senate Appropriations Committees resolved to produce a single **Omnibus Appropriations Act for FY1951**. The Act was passed, but it was adopted late—two months after the new FY1951 had begun. Thereafter, the House and Senate reverted to individual appropriations measures.

### **1967 President’s Commission on Budget Concepts**

Meanwhile, though the **1921 Budget Act** had streamlined the budget process, by the 1960s, budgets from the executive branch were presented in various forms—the **administrative budget**, the **consolidated cash budget**, and the **national income accounts budget**.<sup>29</sup> These presentations of the budget\* were often opaque and confusing to the public, the media, and even policymakers. As noted in the **1967 Report of the President’s**

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\*The 1967 *Report of the President’s Commission on Budget Concepts* defined these approaches to budgeting in its Glossary as follows:

**“Administration Budget—**A financial plan for receipts and expenditures of funds owned by the Federal Government, including general funds, special funds, public enterprise funds, and intragovernmental revolving and management funds.

**“Consolidated Cash Budget—**[Receipts From and Payments to the Public]—A statement combining administrative budget transactions with those of trust funds, deposit funds, and Government-sponsored enterprises (with the elimination of certain intragovernmental transactions) to show the flow of cash between the Federal Government and the public.

**“National Income Accounts (NIA) ‘Budget’—**A measure of receipts and expenditures of the Federal Government sector of the national income and product accounts. It includes Federal trust fund transactions, but excludes loans and similar transactions since they consist of the exchange of financial assets or physical assets which are not newly produced and therefore do not contribute to current ‘income.’”



**Commission on Budget Concepts**, “This confusion of concepts makes it difficult for the ordinary citizen to keep abreast of what his government is doing.”<sup>30</sup> Staff papers of the commission observed:

*That this confusion extends to press coverage is evidenced by the presentation of the 1968 budget headline story. The Associated Press used the administrative budget total as its lead, ... “LBJ’s Budget Hits Record \$135 Billion.” The United Press International used the consolidated cash total as its lead, ... “1968 Budget Hits Record \$172.4 Billion.” The New York Times headline read “\$169.2 Billion Budget Provides \$73 Billion for Defense and Limited ‘Great Society’ Rises,” using the NIA budget total.<sup>31</sup>*

The 1967 Report recommended the adoption of a **unified budget**, under which “all Federal funds and trust funds ... are melded together ... thereby improving the understanding of the scope of the Federal budget and analysis of the budget’s impact on ... the economy.”<sup>32</sup> The report served to “set forth an overarching framework of budget concepts that largely underpins the budget process in use today.”<sup>33</sup> Just a few short years after the report, a **Joint Study Committee on Budget Control** was established in 1972, and from this committee emerged the budget system, under which the federal government operates today.

### ***Congressional Budget & Impoundment Control Act of 1974***

The ***Congressional Budget and Impoundment Control Act of 1974*** grew out of both the Joint Study Committee and spending abuses perpetrated by the Nixon Administration. Though the budget aspects stand out most vividly from the law, impoundment control is also worth special mention as it directly affected the Congressional Power of the Purse.

Presidential **impoundments**—a failure to spend money appropriated by Congress—were an administrative function of the executive, dating to the Jefferson Administration in 1801. Historically, this function of the executive was non-controversial—for instance, deferring the expenditure of funds by a year—though the function expanded with President Franklin D. Roosevelt refusing “to spend money for the purposes appropriated.”<sup>34</sup> However, President Richard Nixon took this power to new levels. Whereas impoundments had historically been of little consequence, Nixon’s impoundments for FY1973 “reached about \$18 billion\* (far more than any previous President had impounded) and represented a sizeable share of the approximately \$170 billion in annual appropriations ...”<sup>35</sup>

***The 1967 Report recommended the adoption of a unified budget, under which “all Federal funds and trust funds ... are melded together ... thereby improving the understanding of the scope of the Federal budget and analysis of the budget’s impact on ... the economy.”***

***Historically, impoundments were non-controversial—for instance, deferring the expenditure of funds by a year—though the function expanded with President Franklin D. Roosevelt refusing “to spend money for the purposes appropriated.” President Richard Nixon took this power to new levels.***

\* \$18 billion in 1973 is roughly equivalent to \$96 billion in 2015.

***The enduring legacies of the 1974 Congressional Budget Act are the institutions it created within Congress—the House and Senate Budget Committees and the Congressional Budget Office (CBO)—and the budget process that continues to this day.***

In response to this executive encroachment on the Congressional Power of the Purse, and with the completion of work by the Joint Study Committee on Budget Control, the *Congressional Budget and Impoundment Control Act of 1974* came into being. The law was passed by Congress and—in the wake of the Watergate Scandal—was signed into law on July 12. President Nixon would resign the presidency less than a month later on August 9, 1974. The law effectively ended executive impoundments, as impoundments subsequent to the law have required Congressional endorsement, which has not been forthcoming.

The enduring legacies of the law are the institutions it created within Congress—the **House** and **Senate Budget Committees** and the **Congressional Budget Office (CBO)**—and the budget process that continues to this day.

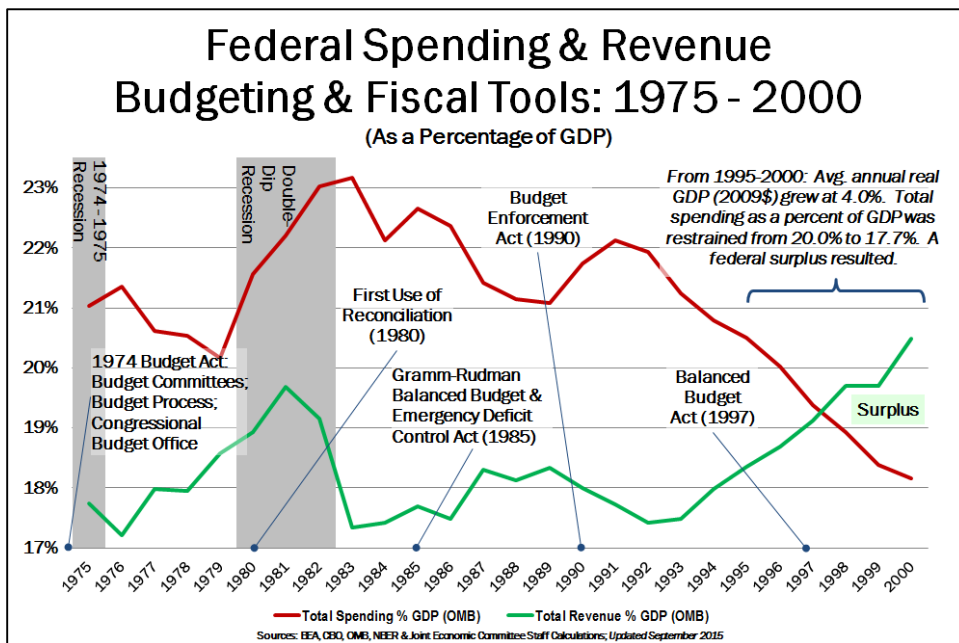
So, during the five full decades during which the *1921 Budget Act* was in full effect, total federal spending as a percent of the economy averaged 3.67 percent in the 1920s; 8.47 percent in the 1930s; 24.08 percent in the 1940s (with World War II spending); 17.35 percent in the 1950s; and 18.15 percent 1960s. The country had come a long way in a short time from federal spending averaging less than 3.0 percent of the economy.

For the totality of this period (1921 – 1974), when this profound shift in philosophy occurred, total federal spending as a percent of the economy averaged 14.65 percent—a dramatic jump from the 2.80 percent average prior to the *1921 Budget Act*. Real GDP grew at an average pace of 3.98 percent, while the nation’s total population grew by 97 percent.

## **1975 – 2000: Budgeting & Fiscal Tools**

***The new Budget Committees were organized and held their first hearings the month following enactment of the law; and the CBO came into existence six months later.***

Time was not wasted in opening the *1974 Congressional Budget Act* era. The new Budget Committees were organized and held their first hearings the month following enactment of the law; and the CBO came into existence six months later.<sup>36</sup> The new process worked smoothly with passage of both a “first” and “second” budget (as required by the law) in fiscal years 1976 through 1982, as “the two Budget Committees often acquiesced in the preferences of the leadership and other committees.”<sup>37</sup> After 1983, Congress moved to adopt a single Budget Resolution each year, and in 1985, this practice of a single budget was formalized in law, and continues through the present.<sup>38</sup>



## Use of the Reconciliation Process

One of the features of the new budget era was a fiscal tool known as **reconciliation**, which is a process, through which existing law can be changed “to bring spending, revenue, or debt-limit levels into conformity with budget resolution assumptions.”<sup>39</sup> This process begins with the inclusion of reconciliation instructions in the budget resolution. These instructions direct specific committees to develop and report legislation to achieve budgetary outcomes, which are numerical targets and not program-specific. When multiple committees are involved, the reported legislation is melded together by the Budget Committees. The reconciliation legislation is then considered on an expedited basis, with a simple majority vote in the Senate.<sup>40</sup>

The first use of reconciliation took place in 1980, in response to deficit projections and the poor economic performance and inflation during the Carter Administration. Reconciliation had previously only been available in the “second” budget, but due to the work of the Budget Process Task Force Chairman, Rep. Leon Panetta, reconciliation became an option for use in the “first” budget.<sup>41</sup> The tool was first put to use in the FY1981 budget, which directed multiple committees to reduce outlays and increase revenues, resulting in an estimated spending reduction of \$4.631 billion and an estimated increase in taxes and revenues of \$3.645 billion, with a net deficit reduction of \$8.276 billion in the fiscal year.<sup>42</sup>

The next year, 1981, reconciliation—known as *Gramm-Latta II*, authored by then Rep. Phil Gramm—was used again with new precedents created. The law extended the reconciliation to cover a multi-year period (FY1982 – FY1984); and reconciliation was greatly expanded to advance a significant part of the policy agenda of the Reagan Administration, affecting programs

***Reconciliation is a process, through which existing law can be changed “to bring spending, revenue, or debt-limit levels into conformity with budget resolution assumptions.”***

***Over the whole of President Reagan's two terms, seven reconciliation measures were enacted, though in the mid-1980s, Congress amended the reconciliation process to limit its reach.***

***The Byrd Rule makes it virtually impossible to include extraneous provisions in reconciliation; ... increase deficits for fiscal years beyond the reconciliation measure; or recommend changes in Social Security.***

***In the nation's 178 fiscal years before 1970, the nation ran a deficit 43 percent of the time; by 1985 that percent climbed to 47 percent; presently it is 52 percent.***

ranging from Food Stamps to dairy price supports to Social Security.<sup>43</sup> Over the whole of President Reagan's two terms, seven reconciliation measures were enacted, though in the mid-1980s, Congress amended the reconciliation process to limit its reach.

To curb the practice of including extraneous provisions in reconciliation, the **Byrd Rule** was instituted in 1985, and formally included in the *Congressional Budget Act* in 1990. Named after Senator Robert C. Byrd, the Byrd Rule makes it virtually impossible to include provisions in reconciliation that do not affect outlays or revenues; are beyond the jurisdiction of the instructed committee, which reports the provision; produce incidental changes to outlays and revenues; increase deficits for fiscal years beyond the time-frame of the reconciliation measure; or recommend changes in Social Security.<sup>44</sup>

To this day, reconciliation remains one of Congress's most important tools to control all non-interest spending, excluding Social Security.

### **The Focus on Deficits—Gramm-Rudman & Sequesters**

The new budget era and the reconciliation process, in particular, put much greater focus on federal deficits. By 1985, the federal government had run a deficit in every year since 1970, though this was not the historically normative pattern. In years before 1970, the nation ran a deficit 43 percent of the time (in 76 of the nation's 178 fiscal years); by 1985 that percentage climbed to 47 percent (in 92 of the 194 fiscal years); presently—through FY2014—the nation has run a deficit 52 percent of the time (in 117 of the 223 fiscal years). Naturally, this trend received—and continues to receive—much warranted attention, but it led to a focus on treating the symptoms (deficits and debt) rather than the disease (over-spending). Perhaps the most enduring budgetary “treatment” of this period came with the 1985 *Balanced Budget and Emergency Deficit Control Act*—and its subsequent modifications—known as Gramm-Rudman-Hollings (GRH) or simply “**Gramm-Rudman**,” with Sen. Phil Gramm as the driving force.

From the law's inception through the 1990s, the law put tremendous pressure on federal budgeting. Emerging in relation to a debt ceiling impasse, *Gramm-Rudman* focused on federal deficits and deficit targets, but the lasting legacy of the law is its effect on the annual budgeting process.

The *Gramm-Rudman* deficit targets were enforced through a budget sequestration. As a result of the annual sequestration's severity, *Gramm-Rudman*—with one exception—was normally either reduced or waived. (The exception came in 1987 when “a Democratic Congress and a Republican White House came together to replace that sequester with

spending cuts in fiscal years 1988 and 1989 that were larger than those called for by *Gramm-Rudman II*.”<sup>45</sup>)\*

While some have criticized *Gramm-Rudman* as less than effective due to the waiving and reductions of its sequesters, the reality is that the law certainly served as a “spending brake,” keeping federal spending at a level below what it otherwise would have been. *Gramm-Rudman* remained in place through the 1990s and the budget surpluses in FY1998 – FY2001; it lapsed and was not renewed after 2002.

## How the Budget Was Balanced:

### Spending Restraint & Economic Growth

Notably, however, though *Gramm-Rudman* served as a “spending brake,” it was not the immediate reason for the brief period of federal surpluses from FY1998 – FY2001. Likewise, direct spending reductions were not the reason either. Rather, two factors were the primary drivers behind the budget surpluses at the close of the last century: (1) growth in federal spending was restrained; and (2) economic growth was strong.

The Republican takeover of Congress following the 1994 election represented a major shift in the focus and direction of the Congress. Proposals to abolish entire departmental agencies and cut spending abounded; though in actuality, relatively little was cut. In real dollar terms, from the first Republican budget for FY1996 through the last year of surplus in FY2001, mandatory spending *increased* by 18.2 percent and discretionary spending *increased* by 12.5 percent; only interest spending—over which the current Congress has little control—*decreased* during the period. However, though spending increased in real dollar terms during this period, as a percent of the economy, spending actually *declined*. In FY1995, non-interest mandatory spending equaled 9.75 percent of GDP and discretionary spending equaled 7.19 percent of GDP. In spite of the spending increases, by FY2001, mandatory spending amounted to only 9.56 percent of GDP and discretionary spending amounted to only 6.16 percent of GDP.

So how did a government running a deficit—as it had for the previous quarter century—manage to spend more each year, and yet balance the budget with respectable surpluses, all without major tax increases? Simply put: This is a clear demonstration of the power of economic growth. While combined discretionary and non-interest mandatory real spending increased by 15.91 percent, the economy grew by 21.73 percent. This demonstrates a politically viable path to a balanced budget and fiscal stability: **Restrain the growth in federal spending below the rate of economic growth, and a sustainable fiscal environment will follow.**

*Two factors were the primary drivers behind the budget surpluses at the close of the last century: (1) growth in federal spending was restrained; and (2) economic growth was strong.*

*Though spending increased in real dollar terms during this period, as a percent of the economy, spending actually declined. That the budget was balanced with respectable surpluses is a clear demonstration of the power of economic growth.*

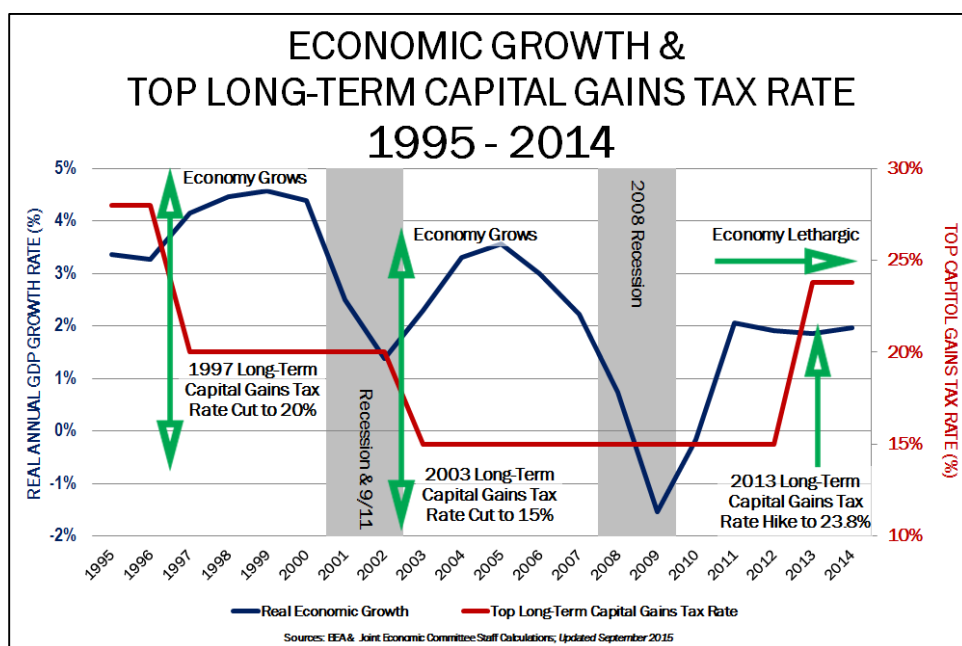
\* *Gramm-Rudman II* was the 1987 *Balanced Budget and Emergency Deficit Control Reaffirmation Act*.



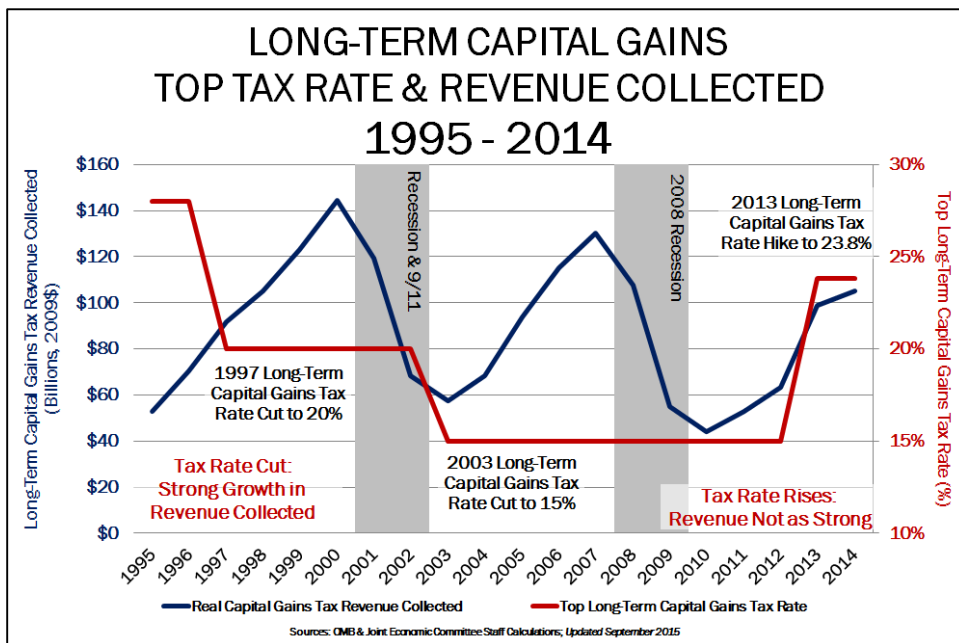
Yet restraining the growth of federal spending below the rate of economic growth to a degree that will produce surpluses is not always so simple. The Congress can control much of the spending growth, but it cannot exert direct control over the business cycle and economic growth. Hence, if spending growth is restrained while the economy is weak, fiscal benefits will still accrue from the restraint, though the effects of the restraint are less apparent because less federal revenue is collected when the economy is weak, meaning that deficits may persist.

***Though the federal government cannot directly control economic growth, it can have an indirect, positive effect on the economy if it pursues policies that will reduce the burden of government on the private sector, therein providing significant help in spurring private sector economic growth and job creation.***

Still, though the federal government cannot directly control economic growth, it can have an indirect, positive effect on the economy if it pursues policies that will reduce the burden of government on the private sector, therein providing significant help in spurring private sector economic growth and job creation.



During the period of budget surpluses, a prime example of such a policy path involved a reduction in the rate of taxation on long-term capital gains. In 1997, the Republican-controlled Congress and Democrat-controlled White House agreed to a reduction of the top long-term capital gains tax rate from 28 percent to 20 percent. This reduction had a powerful effect on the movement of capital, which could then be shifted from less to more productive economic uses. In the process, realized capital gains experienced a huge jump in real 2009\$ from \$238.7 billion in FY1995 to \$783.2 billion in FY2000. Hence, though the tax on long-term capital gains had been lowered, taxes paid on long-term capital gains rose significantly—in real 2009\$—from \$52.8 billion in FY1995 to \$144.4 billion in FY2000.



Lest this just be attributed to tech stocks and the dot-com bubble of the late 1990s, when the tax rate on long-term capital gains was dropped further to 15 percent in 2003, another explosion occurred in capital gains realized, rising—in real 2009\$—from \$315.7 billion in FY2002 to \$951.3 billion in FY2007. And again, when the market anticipated a big increase in the tax rate on long-term capital gains—from 15 percent to 23.8 percent—in 2013, there was a rise in capital gains realized as investors took their profits prior to the tax rate rising.

With respect to the period of the budget surpluses at the close of the century, the evidence provides a case study for how to balance the budget in a politically viable manner: Restrain spending, and pursue policies that help the private sector economy grow.

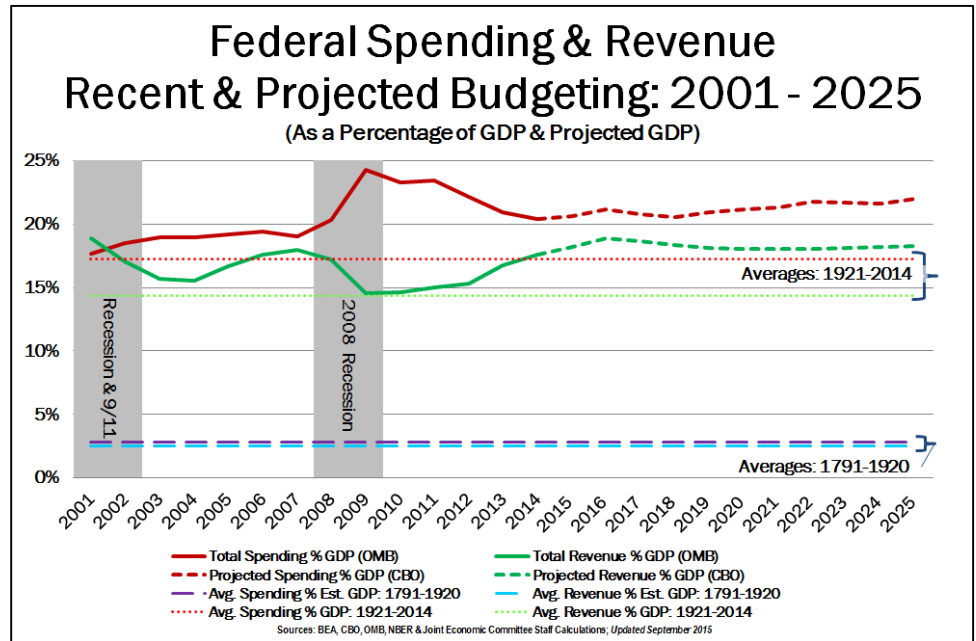
*With respect to the period of the budget surpluses at the close of the century, the evidence provides a case study for how to balance the budget in a politically viable manner: Restrain spending, and pursue policies that help the private sector economy grow.*

## Recent Budgeting: 2001 – 2015

### **A New Era of Big Government (2001 – 2010)**

Unfortunately, the period of surpluses was short-lived. Congress fought over how to use the surplus—spend it, pay down the debt, or return it to the taxpayers; the business cycle changed with the bursting of the dot-com bubble; and then the 9/11 terrorist attacks and military engagements returned the federal budget deficits. From FY2001 to FY2006, total federal spending as a percent of the economy had grown from 17.68 percent to 19.43 percent of GDP, and primary spending rose from 15.72 percent to 17.77 percent of GDP; the nation swung from a surplus of 1.22 percent to a deficit of 1.82 percent of GDP; and debt held by the public grew from 31.50 percent to 35.34 percent of GDP.

Notwithstanding the economic headwinds, during these five fiscal years, the economy still managed to grow at a real average annual rate of 2.68 percent—thanks in large part to the pro-growth policies of the 2003 tax cut. While 2.68 percent is not much to celebrate, it is strong compared to the average real growth rate of 1.02 percent since 2008.



With the economy slowing—compared to the real economic growth of the post-1997 capital gains tax cuts, which averaged 4.39 percent annually—revenues declined from 18.90 percent to 17.61 percent of GDP. Yet as the data demonstrates, unrestrained spending played a bigger role in federal deficits than a lack of revenue. As a percentage of the economy, spending increased by 1.75 percent of GDP, and revenues decreased by 1.29 percent.

Meanwhile, as the nation’s economy slumped into the 2008 financial crisis and the Great Contraction, the climate was ripe for a massive government expansion through bailouts, Keynesian stimulus spending, and the massive healthcare program, known as Obamacare. Between the Democrat takeover of Congress following the 2006 election and FY2010, in real 2009\$ terms, total federal spending grew by 21.47 percent, while primary outlays increased by 25.27 percent. For the whole of the decade, in real dollars, total federal spending grew by 56.54 percent, and primary outlays grew by 68.67 percent. A new era of progressivism seemed to put an end to President Bill Clinton’s 1996 State of the Union declaration that “the era of big government is over.”

## 2011 — A Turning of the Tide?

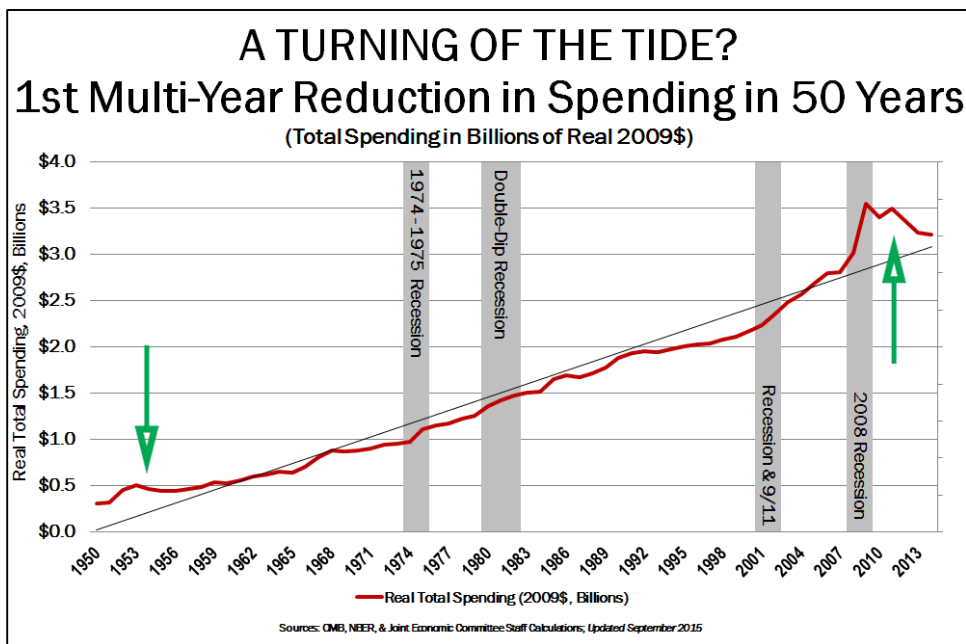
However, the glee of progressives was short-lived as the long-established center-right inclination of the American electorate reverted to their prime form, returning Republicans to control of the House in 2010 and the Senate

***The nation’s economy slumped into the 2008 financial crisis and the Great Contraction, creating a climate ripe for a massive government expansion through bailouts, Keynesian stimulus spending, and the massive healthcare program, known as Obamacare.***

in 2014, with renewed confidence in the party's policies for economic growth and fiscal discipline.

The effect of the 2010 election was dramatic and immediate beginning in 2011, when the Republican Congress began reigning in a runaway government, delivering the first consecutive years of reduced federal spending in more than a half century. For three consecutive fiscal years—FY2012 – FY2014—both total outlays and primary outlays shrank in real 2009\$ terms from the preceding year. Perspective must be maintained that this followed a period of record federal spending, and relative to the total size of government, the reduction was not huge—about \$120 billion in both FY2012 and FY2013, and about \$5 billion in FY2014. Nonetheless, it is still a noteworthy accomplishment of the Republican Congress. The last period of two such years of decline occurred in FY1954 – FY1955; and to find three consecutive years of spending decline, one must look to the drawdown in federal spending following World War II.

*The effect of the 2010 election was dramatic and immediate beginning in 2011, as the Republican Congress delivered the first consecutive years of reduced federal spending—both total and non-interest spending—in more than a half century.*



No one should be popping champagne corks while primary spending remains at 19.08 percent of GDP, the government continues to run a deficit, and publicly-held debt is at 74.40 percent of GDP. Yet, some ground has been regained with respect to restraining spending and putting the focus on policies that will help to create jobs and economic growth.

## The Task Ahead:

### Restraining Spending in an Enduring Way

America faces a bleak fiscal future on our current fiscal path. The 2015 *Long-Term Budget Outlook* released by CBO, offers an especially grim picture of our fiscal state in light of an economy that is projected to average real growth of only 2.28 percent over the next 75 years.<sup>46</sup>

***Not a single year of surplus—with respect to either total or primary spending—is achieved in CBO’s 75-year projection, with publicly-held debt climbing to 181 percent of GDP in 2090.***

***Congress—which still has the Power of the Purse—must take charge of the nation’s fiscal situation, make potentially difficult political decisions, and put the nation on a sustainable spending path going forward.***

As a percentage of the economy, total non-interest federal spending—driven by higher health care and Social Security outlays—is projected to be 19.2 percent in FY2015 followed by a slight dip and then rise back to 19.2 percent in FY2025; jump to 21.1 percent in FY2040; and explode to 25.7 percent by FY2090. Net interest payments to service the debt may be even worse: As a percent of the economy, they are projected at 1.3 percent in FY2015—with historically low interest rates; 3.0 percent in FY2025; 4.3 percent in FY2040; and 7.5 percent in FY2090. Combined, the total spending as a percentage of the economy is projected at 20.5 percent in FY2015; 22.2 percent in FY2025; 25.3 percent in FY2040; and 33.2 percent in FY2090.

The picture is not better for revenues. As a percentage of the economy, revenues (primarily taxes) are projected to rise from 17.7 percent in FY2015 to 18.3 percent in 2025, and to 19.4 percent in FY2040—a full 2 percent higher than the average since FY1965—and extended out 75 years to FY2090, as high as 23.8 percent. Yet, historical evidence suggests it is unlikely that such a high rate of taxation would be sustainable for long; individuals would change behavior and activities—likely to the detriment of the economy—to find shelter from such punitive tax rates. Job creation and economic growth would remain weak with such a high rate of taxation, exacerbating a vicious economic and fiscal climate.

Then, looking at the trend lines of spending and revenue, it is readily apparent that the publicly-held debt will grow much larger, even as a share of the economy—from 74 percent in FY2015; to 78 percent in FY2025; to 103 percent in FY2040; and to 181 percent in FY2090. Not a single year of surplus—with respect to either total or primary spending—is achieved in CBO’s 75-year projection.

Clearly, Congress—which still has the Power of the Purse—must take charge of the nation’s fiscal situation, make potentially difficult political decisions, and put the nation on a sustainable spending path going forward. Congress needs to follow the path charted in the late 1990s: Restrain spending and pursue policies that will foster private sector job creation and economic growth.

Beyond the fiscal decisions and economic environment, which ended the surplus years of the late 1990s, those surplus years were also short-lived because many placed the focus on the symptom—federal deficits—rather than on the cause of the deficits—spending. In short, there was inadequate focus on the correct economic metrics, and a failure to lock-in the correct metrics to help forge a new sustainable spending path that would endure. Had Congress at that time enacted an annual cap on federal spending in line with a sustainable fiscal path, the nation would be in much better fiscal shape today.



## Focus on What Congress Can Control—Primary Spending

Yet, what are the correct metrics? What spending should be capped—discretionary spending, total spending, defense or non-defense spending, or some other category? Rather than getting bogged down in discussions of discretionary and mandatory spending, or defense and non-defense spending, economically, it is much better to look at spending in a slightly different way. Two simple categories should be recognized: **(a)** Spending that Congress can control; and **(b)** Spending that Congress cannot control.

**(a)** The spending that Congress can control includes everything that Congress can adjust. It includes all programs that Congress funds through the appropriations process, known as discretionary spending; and it includes all programs that Congress funds through the authorization process, known as mandatory (or entitlement) spending. Since mandatory spending is typically on autopilot, many forget that Congress actually does have just as much control over this spending as it does over discretionary—but the Power of the Purse extends to these programs as well. All Congressionally-controlled spending is known as **Primary Spending**.

**(b)** The second category includes **spending that Congress cannot control**. Spending to service the nation's debt—interest and principal as it comes due—falls into this category, as the current Congress has no control over current debt service payments. These payments are influenced by current interest rates and past Congressional decisions. In essence, whenever Congress borrows money, it avoids the difficulty of justifying its spending decisions to current taxpayers, and instead places a tax on future taxpayers. So, with respect to current debt servicing payments, Congress does not have the ability to influence or adjust the payments, putting debt servicing costs beyond the current Congress's power to control.

Hence, in contemplating spending restraint, it makes economic sense to focus exclusively on the spending that the current Congress can control—Primary Spending. Once this metric is correctly identified, the question turns to how primary spending should be restrained. Should there be a hard cap fixed at a set dollar amount; should it be as a percentage of GDP; or should it be tied to some other aspect of the federal budget process?

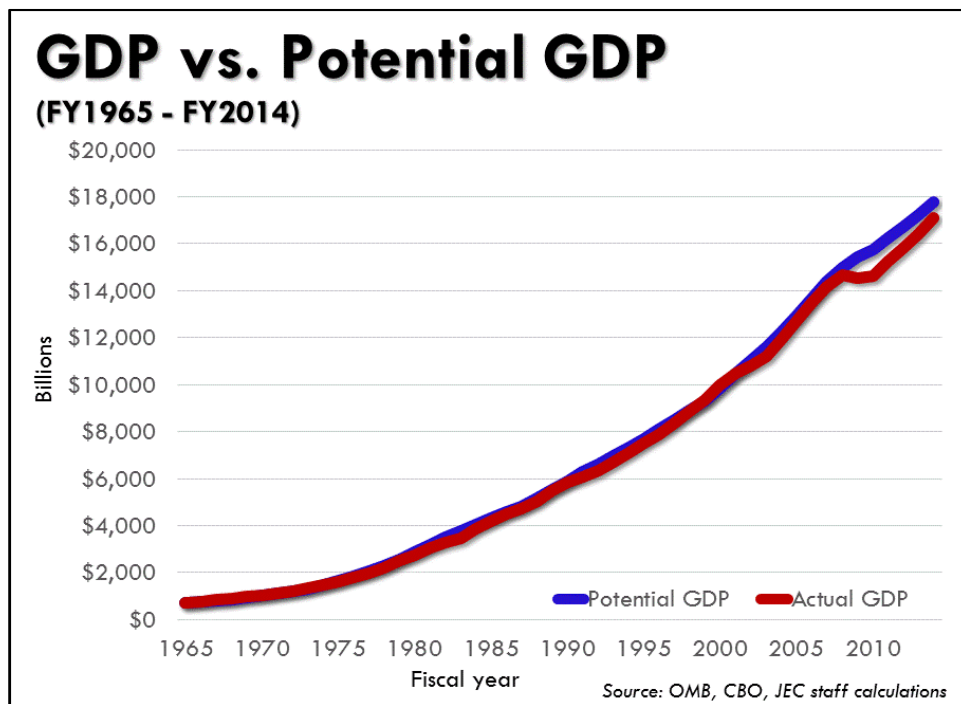
***Primary Spending is the spending that Congress can control, including all programs that Congress funds through the appropriations process (discretionary spending), and all programs that Congress funds through the authorization process (mandatory spending).***

***In contemplating spending restraint, it makes economic sense to focus exclusively on the spending that the current Congress can control—Primary Spending.***

## Use a Stable Base for a Spending Cap—Potential GDP

A hard cap set at a specific number would need frequent updating (due to inflation), and Congress would still be prone to waive it. Likewise, capping primary spending as a percentage of GDP is imperfect: During good economic times, GDP would rise and there would be a corresponding expansion in federal spending; during recessions, GDP would plummet, requiring unenforceable spending cuts—right when there is an increased

need for temporary unemployment assistance programs. The ideal base for a spending cap would be similar to a GDP-cap, but it would provide greater spending restraint in economic booms and greater flexibility in economic downturns. Fortunately, such a measurement, which helps to smooth the business cycle, does exist: Potential GDP.



***Using potential GDP as the base of a spending cap would help to eliminate the uncertainty regarding U.S. fiscal policy going forward.***

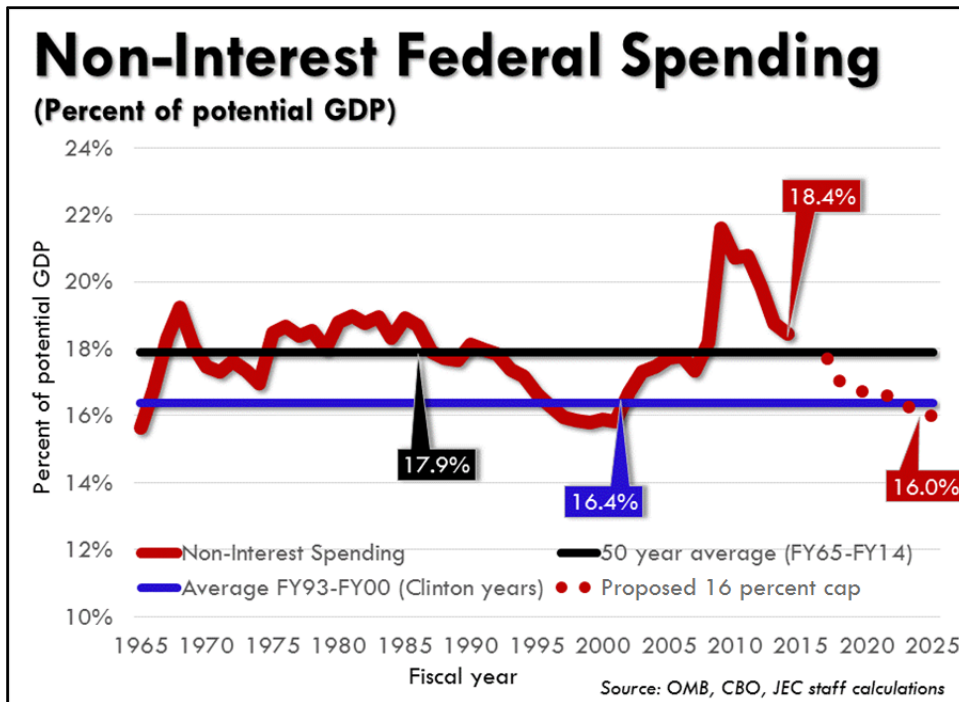
Potential GDP, as measured by CBO, is what GDP would be if the economy were operating at full employment without inflation. Potential GDP helps to smooth out the business cycle; and over time, the variance between actual and potential GDP is small. Moreover, basing a spending cap on potential GDP is very helpful for budgeting purposes, as it creates a more predictable budget path over an extended period of time. Currently, CBO publishes its potential GDP projections on a forward-looking basis, covering the entirety of the 10-year budget window. Using potential GDP as the base of a spending cap would help to eliminate the uncertainty regarding U.S. fiscal policy going forward.

### **A Spending Level That Does Not Harm Job Creation & Economic Growth**

If Congress were to enact an economically sound spending cap, such as what is described in the preceding subsections—capping primary spending as a percentage of potential GDP—the next logical question is: What is the appropriate percentage, at which to establish the spending cap?

In an age of Social Security, Medicare, and national defense expenditures, spending is not going to return to pre-1921 *Congressional Budget Act* spending levels—at least not any time soon. However, the cap can still be lower than expected, because interest outlays are not included in the spending cap since Congress has no control over the current costs for servicing the debt.

***A primary spending cap can be lower than expected, because interest outlays are not included in the cap since Congress has no control over the current costs for servicing the debt.***



For instance, moving toward permanently capping primary spending at 16 percent of potential GDP would be a desirable level in three respects: (1) An outlay level of 16 percent of potential GDP is sustainable, and—when compared to higher spending rates—would do less to hinder private sector job creation and economic growth; (2) Such a spending level is attainable with necessary reforms to entitlement programs and the transfer of non-core government functions to private sector entities; and (3) Such a spending level, when combined with economic growth, would make the national debt much more manageable, as it would help the debt to shrink as a percentage of the economy. Further, America has previously enjoyed much economic prosperity with such a primary spending level, most recently in the 1990s, so it is clear that the rate is achievable.

***In the current environment—moving toward permanently capping primary spending at 16 percent of potential GDP would be a desirable level.***

## **PART 2:**

### **THE FEDERAL DEBT & THE DEBT CEILING**

#### **A Change in the Approach to Debt**

***A new trend in relation to federal spending and debt was especially manifest following the Vietnam War: An historically high and enduring level of debt as a percentage of the economy.***

Notwithstanding the successful launch of the new budget process in 1975, the *Gramm-Rudman* spending brake, and the ultimately balanced budgets at the close of the 20<sup>th</sup> century, a new trend in relation to federal spending and debt was especially manifest following the Vietnam War: An historically high and enduring level of debt as a percentage of the economy.

Only once in the nation's history—in the mid-1830s—had the national debt been paid down in full, and this period corresponded with the previously referenced disastrous economic policies of President Andrew Jackson, which nearly bankrupted the nation and led to the second deepest depression in American history, only behind the Great Depression.<sup>47</sup>

At other times, the nominal debt level was partially paid down or kept constant, but the size of the debt shrank in relation to the economy as the economy grew. For example, with all major American wars, debt has been a primary financing mechanism. Yet following the pronounced spikes in debt associated with the Revolutionary War, War of 1812, Civil War, World War I, and World War II, debt as a percentage of the economy shrank to manageable levels.

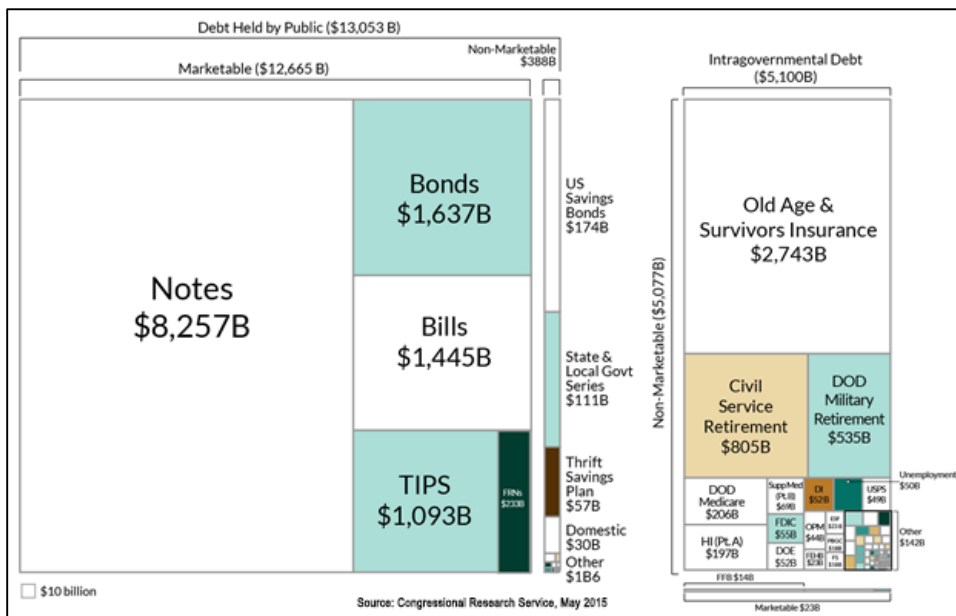
***Whether one attributes the high and enduring level of debt to either the Great Society Programs or to the Cold War is secondary to the point that debt as percentage of the economy did not decline following Vietnam.***

The trend that emerged following Vietnam, however, was for publicly-held debt to increase as a percentage of the economy after the conflict's end. Whether one attributes the high and enduring level of debt to either the Great Society Programs or to the Cold War is secondary to the point that debt as percentage of the economy did not decline following Vietnam. This is a troubling trend, especially considering that debt held by the public has jumped from 39.59 percent of GDP in FY2008 to 74.40 percent of GDP in FY2014; and the gross federal debt has exceeded 100 percent of GDP since FY2012.

#### **What Constitutes the Debt Subject to the Debt Limit**

As a preliminary note in addressing the federal debt, there are two primary types of debt, which combine (with a few minor exceptions) to form **total federal debt subject to the statutory debt limit**. These two types are:

- (1) Debt held by the public**, which results from the government selling debt to the public to finance budget deficits or specific projects; and
- (2) Debt held by government accounts (Intragovernmental Debt)**, which results “when the federal government issues debt to certain accounts, such as the Social Security, Medicare, and Transportation trust funds, in exchange for their reported surpluses.”<sup>48</sup>



## Debt Limit History

Article 1, Section 8, Clause 2 of the U.S. Constitution endows Congress with the power “*to borrow money on the credit of the United States.*” Hence, Congress has the Constitutional responsibility for determining how much money the country may borrow and how much debt outstanding it may have at any one time.

### The Debt Limit Prior to 1939

An official “debt limit” was not established until July 1939—when it was set at \$45 billion.\* In prior years, Congress effectively limited the nation’s indebtedness through micromanaging the issuance of debt instruments, such as Treasury bonds and notes. “Bonds were authorized to finance specific projects, and the Secretary of the Treasury had little or no discretionary authority to choose the terms of a new issue.”<sup>49</sup>

Typically, Congress would authorize the amount of a debt issuance, for a specific purpose, at a specific interest rate and stated term. For example, on July 22, 1846, during the Mexican-American War, Congress authorized the President and the Treasury to issue notes of up to \$10 million and “not bear a higher rate of interest than 6 percent per annum;”<sup>50</sup> and with the Spooner Act of June 26, 1902, Congress authorized “up to \$130 million of 30-year, 2-percent bonds to finance construction”<sup>51</sup> of the Panama Canal.

For the 148 years from 1791 through the 1939 fiscal year, debt held by the public averaged a meager 13.54 percent of the economy; and the federal government had only run a budget deficit in 54 (36.5 percent) of those 148 years. Moreover, prior to World War I, the nation’s greatest level of nominal

*Before 1939, Congress effectively limited the nation’s indebtedness through micromanaging the issuance of debt instruments, such as Treasury bonds and notes.*

\* \$45 billion in 1939 is equal to approximately \$767 billion in 2015.



indebtedness occurred in FY1866 when nominal debt reached \$2.76 billion\* (28.92 percent of estimated GDP), and the nation's greatest level of indebtedness as a percent of estimated GDP occurred in 1791 at 36.63 percent (\$75.5 Million†).

### World War I to 1939

World War I presented challenges of a greater financial magnitude. As with prior war- or project-specific bond issues, so too was the Great War financed, but the Secretary of the Treasury was granted broader authority over the bond issues to meet both war needs “and other public purposes authorized by law,” as well as latitude in determining how the bonds would be issued.<sup>52</sup>

Federal debt swelled from \$1.23 billion (2.75 percent of estimated GDP) in FY1916 to \$25.46 billion (32.74 percent of estimated GDP) in FY1919. Not since the early 1790s had federal debt as a percent of the economy been higher. Federal debt had not even been higher as a result of the Civil War when federal debt peaked at 31.53 percent of estimated GDP in FY1869.

This level of indebtedness presented new challenges to the U.S. government, particularly with respect for how to handle or refinance the maturing debt. Thus beginning in 1921, Congress began to expand Treasury's authority, shifting from issuing bonds to finance specific projects or wars to using bonds as a means of finance and paying down maturing debt. The shift in itself was not a bad thing, and may be seen as part of the broader modernization of the U.S. economy. Even with this shift, a third of the debt had been paid down by FY1930 when federal debt declined to \$16.19 billion (16.45 percent of GDP), but then came the Great Depression and New Deal spending.

Federal debt grew every year in the 1930s, cementing the new reality that debt was no longer exclusively issued to finance specific projects. By the late 1930s, a \$45 billion limit on total indebtedness was in place, with stipulations on what type and how much of various debt instruments would be allowed. In 1939, Congress removed the sub-ceilings allowing Treasury officials freedom “to exercise their professional judgment on the appropriate maturities of new issues.”<sup>53</sup> As noted by a House Ways and Means Committee report, the nation would be best served with the Treasury allowed “to issue securities best suited at the time to meet the conditions of the market and the needs of the Government.”<sup>54</sup>

Hence, after 1939, Congress set the top-line debt ceiling, with greater freedom granted to Treasury in regard to how the debt would be constituted.

***Beginning in 1921, Congress began to expand Treasury's authority, shifting from issuing bonds to finance specific projects or wars to using bonds as a means of finance and paying down maturing debt.***

***After 1939, Congress set the top-line debt ceiling, with greater freedom granted to Treasury in regard to how the debt would be constituted.***

\* \$2.76 billion in 1866 is equal to approximately \$42.5 billion in 2015.

† \$75.5 million in 1791 is equal to approximately \$1.96 billion in 2015.

## The Post-War Statutory Debt Limit

World War II resulted in the greatest level of indebtedness in the nation's history with debt held by the public peaking at 106.08 percent of GDP and gross federal debt peaking at 118.86 percent of GDP in FY1946. In nominal terms, publicly-held debt reached \$241.86 billion and total federal debt reached \$270.99 billion in FY1946. That same year, Congress reduced the World War II debt ceiling from \$300 billion to \$275 billion—a level that lasted through the seasonal fluctuations in revenue (tax payments received and outlays) until added pressures from the Korean War and defense appropriations resulted in the first debt ceiling crisis in 1953.

***World War II resulted in the greatest level of indebtedness in the nation's history with debt held by the public peaking at 106.08 percent of GDP and gross federal debt peaking at 118.86 percent of GDP in 1946.***

## The 1953 Debt Crisis

In 1953, as the debt ceiling was being approached and the Eisenhower Administration was urging Congress to raise the ceiling by \$15 billion to \$290 billion, fiscal conservatives balked at the request. Senator Harry Byrd of Virginia declared that he would do all that he could to block the request, and “the *Wall Street Journal* opined on its editorial page that ‘to impose a limit on the government’s debt and then to change it the moment it begins to squeeze makes of the whole thing a trick for fooling people.’”<sup>55</sup> While the House approved the increase, the Senate did not take action before adjournment. In a difficult situation, the Eisenhower Administration averted breaching the debt ceiling by monetizing leftover gold from the FDR gold confiscation law in the early 1930s. This allowed a one-year reprieve, and when the issue revived in 1954, a compromise on the level of increase was reached between the Senate and the White House, raising the ceiling by \$6 billion to \$281 billion. However, some senators noted at the time that there was little room for “optimism that the rise would, in fact, be temporary.”<sup>56</sup>

## The Debt Limit Since 1980

Since 1939, there have been over 90 measures adjusting the debt ceiling. These adjustments have come via regular legislative procedures of both Chambers, through reconciliation procedures, and through the Gephardt rule.<sup>57</sup> In the 1980s, the Gephardt rule became a preferred mechanism for increasing the debt ceiling in the House.

The **Gephardt rule**, first used in 1980, was a procedure whereby the House, upon adoption of a Congressional Budget Resolution, would deem a measure adjusting the debt ceiling to have passed the House. This approach “spared” the House from having to vote on the individual increase, and the measure would then be sent to the Senate for consideration under regular Senate procedures. The Gephardt rule was used 10 times before it was abolished at the beginning of the 112<sup>th</sup> Congress in 2011.

***Since 1939, there have been over 90 measures adjusting the debt ceiling. These adjustments have come via regular legislative procedures of both Chambers, through reconciliation procedures, and through the Gephardt rule.***

During the Gephardt rule era, publicly-held debt increased from \$711.923 billion in 1980 to \$9.019 trillion in 2010; total federal debt increased from

\$909 billion in 1980 to \$13.529 trillion. The debt limit increased from \$925 billion to \$14.294 trillion. At the time of this writing (September 2015), publicly-held debt is \$13.152 trillion; and total federal debt is \$18.151 trillion.<sup>58</sup>

***The statutory debt limit remains the one macro tool for the whole of Congress to exert its will over the total level of federal indebtedness.***

***Gramm-Rudman was integral to the debt limit in that its adoption paved the way for the 1985 debt limit increase.***

***The Andrews AFB negotiation is a clear example of a Democrat-controlled Congress using the debt limit as a tool to leave spending untouched while raising taxes to the detriment of economic growth, job creation, and prosperity.***

### **Using the Debt Limit to Affect Budgeting**

Though the debt limit is not an optimal leverage tool for affecting changes to budgeting policy (due to the economic risks of potential default as well as the economic volatility resulting from the uncertainty of debt limit battles), it has nonetheless been so used by both parties over the past three decades, because it remains one of the few effective tools for Congress to exert its Constitutional responsibility over federal borrowing.

Some argue that the debt limit is antiquated, or that the limit is already controlled by the Appropriations Committees (with respect to discretionary spending) and authorization committees (with respect to mandatory spending). Yet, the statutory debt limit remains the one macro tool for the whole of Congress to exert its will over the total level of federal indebtedness. Three instances of Congress using the debt ceiling as a tool to advance its then-current philosophy are worth noting.

#### ***Gramm-Rudman (1985)***

The 1985 *Balanced Budget and Emergency Deficit Control Act* (Gramm-Rudman, discussed earlier in this paper), was a mechanism developed by the deficit-focused 99<sup>th</sup> Congress. The Senate was controlled by Republicans, though when passed in December *Gramm-Rudman* also enjoyed the support of Senate Democrat Leader Robert Byrd. *Gramm-Rudman* was integral to the debt limit in that its adoption paved the way for the 1985 debt limit increase.

#### ***Andrews AFB Negotiation (1990)***

A second instance occurred in 1990. With the Democrats firmly in control of both the House and the Senate, and Republicans controlling the White House, a showdown occurred over the debt limit. The result was the infamous **Andrews Air Force Base negotiations**. During the period, there were six temporary increases in the debt limit between August 3 and October 28, with a final permanent increase in the debt limit on November 7. The negotiations at the time appeared to result in a 3:1 ratio of spending cuts to tax increases, but famously, the spending cuts never materialized, and the deal broke President George H.W. Bush's pledge of "no new taxes."

The Andrews AFB negotiation is a clear example of a Democrat-controlled Congress using the debt limit as a tool to leave spending untouched while raising taxes to the detriment of economic growth, job creation, and prosperity. This shows that the debt limit can be used as leverage to either cut spending or to increase taxes.

***Budget Control Act (2011)***

Most recently, the ***Budget Control Act*** (BCA) emerged from the **2011 debt limit crisis**, as a Republican-controlled House was able to use the debt limit as a leverage tool to push for greater spending restraint in the wake of the excesses in federal spending, which had occurred during the first decade of the 21<sup>st</sup> century. The BCA set defense and non-defense spending caps through FY2021—which have been extended through FY2025—and further, the BCA includes sequester authority for each fiscal year during the period.

***During the 2011 debt limit crisis, a Republican controlled House was able to use the debt limit as a leverage tool to push for greater spending restraint in the wake of the excesses in federal spending.***

**IN BRIEF: THE TRUE “OFF-BUDGET”—REGULATIONS**

One further item deserving consideration on the topic of federal spending and budgeting is the degree to which federal regulations hide the true size and effect of federal budgeting in relation to the economy.

It is important that policymakers and the public come to better understand that the government’s power to regulate imposes significant costs to the economy. Regulation can command the use of private resources, even though the costs of regulations never appear in the federal budget. Moreover, it is well understood that lawmakers can circumvent the democratic process by either taxing future generations through borrowing and debt accumulation; or by delegating decisions to unelected bureaucrats, thereby evading responsibility for imposing prescriptive regulations.

***The government’s power to regulate imposes significant costs to the economy.***

Prescriptive regulation—as distinguished from process-oriented regulation, which facilitates market functions—is a form of taxation and has long been recognized as such.<sup>59</sup> Although federal regulatory agencies generally are supposed to consider the costs and benefits of their regulations, regulatory analyses frequently are inadequate and lack objectivity. Currently, very few federal regulations are the product of thorough, balanced, comprehensive analysis of costs and benefits.<sup>60</sup> Federal prescriptive regulation has been expanding at a disconcertingly high rate, and even conservative estimates of aggregate cost increases exceed the rate of economic growth.

***Prescriptive regulation is a form of taxation and has long been recognized as such.***

While additional consideration of regulations is beyond the scope of this paper, further study of the economic effects of federal regulations, and how to contain them, is certainly worthy of greater examination.<sup>61</sup>

## CONCLUSION

In closing, due to the stockpile of public debt created by generations of lawmakers passing along the debts of yesterday's spending onto the hardworking American taxpayers of today—the United States faces an unprecedented threat to our economic freedom and economic vitality. The ideal of each generation of Americans passing along a brighter, more prosperous nation to their children and grandchildren is under serious assault; and with each passing year, the task of ensuring a brighter tomorrow becomes more difficult.

***It is critical that Congress turn its focus onto restraining federal spending, and pursuing policies that will be conducive to the private sector creating more jobs and generating robust economic growth.***

As such, it is critical that Congress turn its focus onto restraining federal spending, and pursuing policies that will be conducive to the private sector creating more jobs and generating robust economic growth. These are the key ingredients to both (a) increasing the standard of living and opportunities to advance for all Americans; and (b) generating the economic activity that will help to raise revenues (without raising taxes) and put the nation back on track for a bright economic future with a debt that is precipitously declining as a percentage of GDP. One option to accomplish this would be to enact a cap on primary spending as a percentage of potential GDP; but whether this course or another is taken, the time to act is now.



## ENDNOTES

- <sup>1</sup> James Madison, "Federalist 58," *Independent Journal*, February 20, 1788, <http://www.constitution.org/fed/federa58.htm>.
- <sup>2</sup> The first iteration of the House Committee on Ways and Means, created in 1789, was temporary, meeting for just a few months. The Committee reemerged from the 4<sup>th</sup> through the 6<sup>th</sup> Congresses, and in the 7<sup>th</sup> Congress was included as a standing committee in the revised House Rules of 1802. For further details see: U.S. Congress, House of Representatives, Committee on Ways and Means, *The Committee on Ways and Means: A Bicentennial History, 1789-1989*, 100<sup>th</sup> Cong., 1<sup>st</sup> Sess., 1989, H. Doc. 100-244, <http://www.gpo.gov/fdsys/pkg/GPO-CDOC-100hdoc244/content-detail.html>.
- <sup>3</sup> *Ibid.*, 29.
- <sup>4</sup> "About the Committee," U.S. House of Representatives Committee on Appropriations, accessed July 20, 2015, <http://appropriations.house.gov/about/>.
- <sup>5</sup> U.S. Congress, House of Representatives, *The Committee on Ways and Means*, 70-71.
- <sup>6</sup> Gerhard Casper, "Executive-Congressional Separation of Power during the Presidency of Thomas Jefferson," *Stanford Law Review* 487 (1995): 47.
- <sup>7</sup> "About - History," U.S. Senate Committee on Finance, accessed July 20, 2015, <http://www.finance.senate.gov/about/history/>.
- <sup>8</sup> U.S. Congress, House of Representatives, *The Committee on Ways and Means*, 92-93.
- <sup>9</sup> *Ibid.*, p.93.
- <sup>10</sup> "Committee History," U.S. Senate Committee on Appropriations, accessed July 20, 2015, <http://www.appropriations.senate.gov/content/committee-history>.
- <sup>11</sup> U.S. Congress, Senate, *History of the Committee on Finance*, 97<sup>th</sup> Cong., 1<sup>st</sup> Sess., 1981, S. Doc. 97-5, 26-27, <http://www.finance.senate.gov/download/?id=f057dc65-9c25-4ec2-96be-36c67490ecad>.
- <sup>12</sup> Milton Friedman, *A Program for Monetary Stability*, (New York: Fordham University Press, 1959), 10.
- <sup>13</sup> Casper, "Executive-Congressional Separation of Power," 488.
- <sup>14</sup> Keith Stith, "Congress' Power of the Purse," *Yale Law Journal* 87, 7 (1988): 1370.
- <sup>15</sup> *Ibid.*, 1371.
- <sup>16</sup> U.S. Congress, Senate, *Committee on Appropriations: 126<sup>th</sup> Anniversary - 1867-1993*, 103<sup>rd</sup> Cong., 1<sup>st</sup> Sess., 1993, S. Doc. 17, 12.
- <sup>17</sup> Paul Studenski and Herman E. Kroos, *Financial History of the United States*, (New York: McGraw-Hill, 1952), 276.
- <sup>18</sup> *Ibid.*
- <sup>19</sup> U.S. Congress, Senate, *Committee on Appropriations*, 9-10.
- <sup>20</sup> *Ibid.*, 8.
- <sup>21</sup> *Ibid.*, 13.
- <sup>22</sup> Studenski and Kroos, *Financial History*, 278.
- <sup>23</sup> *Federal Budget, Accounting, and Financial Management Laws: Summaries of Selected Provisions* (CRS Report No. 96-696) (Washington, DC: Congressional Research Service, 1996), 9.
- <sup>24</sup> George Will, "The Danger of a Government with Unlimited Power," *The Washington Post*, June 3, 2010, <http://www.washingtonpost.com/wp-dyn/content/article/2010/06/02/AR2010060203278.html>.
- <sup>25</sup> "Our Founding," Congressional Budget Office, accessed July 20, 2015, <http://www.cbo.gov/about/our-founding>.
- <sup>26</sup> Gerald F. Seib, "In Crisis, Opportunity for Obama," *The Wall Street Journal*, November 21, 2008, <http://www.wsj.com/articles/SB122721278056345271>.
- <sup>27</sup> "About the Committee," House Committee on Appropriations.
- <sup>28</sup> U.S. Congress, Senate, *Committee on the Budget - United States Senate: 1974-2006*, 109<sup>th</sup> Cong., 2<sup>nd</sup> Sess., 2006, S. Doc. 109-24, 25, [http://www.budget.senate.gov/republican/public/index.cfm?a=Files.Serve&File\\_id=3ef00980-b6ef-4a0b-b804-df74ef7b1486](http://www.budget.senate.gov/republican/public/index.cfm?a=Files.Serve&File_id=3ef00980-b6ef-4a0b-b804-df74ef7b1486).
- <sup>29</sup> *Report of the President's Commission on Budget Concepts*, (Washington, DC: Government Printing Office, 1967), 95.
- <sup>30</sup> *Ibid.*, 14.
- <sup>31</sup> Michelle Rodgers & Dan Sullivan, "Reconsidering the President's Commission on Budget Concepts of 1967," *Harvard Law School Federal Budget Policy Seminar Briefing Paper No. 30* (2006): 4, [http://www.law.harvard.edu/faculty/hjackson/President\\_Commission\\_30.pdf](http://www.law.harvard.edu/faculty/hjackson/President_Commission_30.pdf).
- <sup>32</sup> U.S. Congress, Senate, *Committee on the Budget*, 26.
- <sup>33</sup> *Ibid.*
- <sup>34</sup> Congressional Research Service, *The Constitution of the United States of America: Analysis and Interpretation*, (Washington, DC: U.S. Government Printing Office, 2004), 578, <http://www.crs.gov/conan/default.aspx?doc=Article02.xml&mode=topic&s=3&t=3|2>.
- <sup>35</sup> U.S. Congress, Senate, *Committee on the Budget*, 29.
- <sup>36</sup> *Ibid.*, 39.

<sup>37</sup> *Ibid.*, 42.

<sup>38</sup> *Ibid.*, 3.

<sup>39</sup> *Ibid.*, 1.

<sup>40</sup> *Ibid.*, 8.

<sup>41</sup> U.S. Congress, House of Representatives, Committee on the Budget, *A Review of the Reconciliation Process*, 98th Cong., 2<sup>nd</sup> Sess., 1984, H.Doc. 98-9, 5.

<sup>42</sup> Megan S. Lynch, *Budget Reconciliation Measures Enacted into Law: 1980-2010* (CRS Report No. R40480) (Washington, DC: Congressional Research Service, 2010), 5, <http://www.crs.gov/pdfloader/R40480>.

<sup>43</sup> *Ibid.*

<sup>44</sup> Bill Heniff Jr., *The Budget Reconciliation Process: The Senate's "Byrd Rule"* (CRS Report No. RL30862) (Washington, DC: Congressional Research Service, 2010), 5, <http://www.crs.gov/pdfloader/RL30862>.

<sup>45</sup> Phil Gramm, "Obama and the Sequester Scare," *The Wall Street Journal*, February 27, 2013, <http://www.wsj.com/articles/SB10001424127887323384604578327792209356054>.

<sup>46</sup> Congressional Budget Office, "The 2015 Long-Term Budget Outlook," data supplement, <https://www.cbo.gov/sites/default/files/cbofiles/attachments/45308-2015-06-LTBOSuppData-4.xlsx>.

<sup>47</sup> Milton Friedman, *A Program for Monetary Stability*, 10.

<sup>48</sup> Andrew D. Austin, *Overview of the Federal Debt* (CRS Report No. R41815) (Washington, DC: Congressional Research Service, 2011), 1, <http://www.crs.gov/pdfloader/R41815>

<sup>49</sup> Kenneth Garbade, "The Evolution of Federal Debt Ceilings," *Liberty Street Economics* (blog), November 14, 2011, <http://libertystreeteconomics.newyorkfed.org/2011/11/the-evolution-of-federal-debt-ceilings.html>

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<sup>51</sup> Kenneth Garbade, *Birth of a Market: The U.S. Treasury Securities Market from the Great War to the Great Depression*, (Cambridge: MIT Press, 2012), 45.

<sup>52</sup> Garb Garbade, "Federal Debt Ceilings."

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<sup>54</sup> *Ibid.*

<sup>55</sup> Kenneth Garbade, "How the Nation Resolved Its First Debt Ceiling Crisis," *Liberty Street Economics* (blog), March 4, 2013, 3, [http://www.newyorkfed.org/research/economists/garbade/garbade\\_blog\\_footnotes.pdf](http://www.newyorkfed.org/research/economists/garbade/garbade_blog_footnotes.pdf)

<sup>56</sup> *Ibid.*, 9.

<sup>57</sup> Bill Heniff Jr., *Legislative Procedures for Adjusting the Public Debt Limit: A Brief Overview* (CRS Report No. RS21519) (Washington, DC: Congressional Research Service, 2012), <http://www.crs.gov/pdfloader/RS21519>

<sup>58</sup> Information on the current level of debt is available at the website of the United States Department of the Treasury: <http://www.treasurydirect.gov/NP/debt/current>

<sup>59</sup> See, for example, Richard A. Posner, "Taxation by Regulation," 2 *Bell J. Econ. & Mgmt. Sci.*, 22, 23 (1971).

<sup>60</sup> For further discussion on the topic of economic analysis in federal regulations, please see: U.S. Congress, Joint Economic Committee, "The Need for Economic Analysis in Federal Regulations," 113<sup>th</sup> Cong., 2<sup>nd</sup> Sess., 2014, <http://www.jec.senate.gov/public/cache/files/1cd9dde4-fe10-4baa-83dc-29a53c111df8/reg-study-april-2014.pdf>

<sup>61</sup> In addition to Joint Economic Committee resources, please see: Jeffrey A. Rosen and Brian Callanan, "The Regulatory Budget Revisited," *Administrative Law Review*, (September 2014, Vol. 66:4), <http://ssrn.com/abstract=2603760>

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