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Capping Federal Spending

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Federal spending has increased 45 percent in the last five years. The government has run deficits in 33 of the last 37 years. The costs of federal programs for the elderly are set to balloon and impose huge burdens on coming generations of young workers.

Federal policymakers are clearly failing to run a “wise and frugal government,” as President Thomas Jefferson advised in his first inaugural address. One problem is that current budget procedures stack the deck in favor of program expansion without regard to the burdens imposed on current or future taxpayers. The costly Medicare prescription drug bill of 2003 and the recent explosion in “pork” spending illustrate how a lack of structural controls leads to an undisciplined scramble to increase spending despite rising levels of red ink.

Part of the solution to the overspending problem is to bind Congress with tighter budget rules, like the rules in place in many states. All the states except Vermont have statutory or constitutional requirements to balance their budgets. In addition, more than 20 states have some form of overall limitation on taxes or spending.¹ Colorado’s constitution caps state revenue growth at the sum of population growth plus inflation. Revenues above the cap are refunded to taxpayers. This sort of cap on the overall budget is sorely needed in Washington to ensure that tough spending tradeoffs are not avoided.

Past Efforts to Control Spending

Congress has occasionally bound itself to limits on the overall budget in the recognition that self-interested actions of legislators can otherwise lead to an uncontrolled spending splurge and soaring deficits. One reform effort was the 1985 Gramm-Rudman-Hollings Act. It established a series of declining deficit targets over five years, which if not met resulted in an automatic cut, or sequester, to a broad range of programs. Congress replaced GRH in 1990 with the Budget Enforcement Act. The BEA imposed annual dollar caps on discretionary (annually appropriated)

spending and “pay-as-you-go” rules on entitlement programs that required the cost of any program expansion to be offset elsewhere in the budget. Those rules contributed to restraint, but they have since expired.

Bolder efforts to control spending and deficits have been debated in Congress but have narrowly failed to pass. A balanced-budget amendment (BBA) to the Constitution was proposed in Congress as far back as 1936.

In 1982 the Senate passed a BBA by a vote of 69-31. In addition to requiring budget balance, the amendment would have limited the annual growth in federal revenues to the growth in national income. Unfortunately, the BBA failed to gain the needed two-thirds approval in the House. At the time, a parallel effort resulted in resolutions being passed in 31 states calling for a constitutional convention to approve a BBA, but that effort came up three states short of the required number.

In 1995 Congress again voted on a BBA, and it again failed. The BBA passed the House by a 300-132 margin, but fell one vote short of passage in the Senate.

Capping Total Federal Spending

Today, reformers are focusing on statutory rather than constitutional efforts to control the budget. And unlike GRH and the BBA, today’s efforts are focused on spending control, not deficit reduction, because of recognition that deficits are simply a byproduct of the more fundamental overspending problem.

A number of House members, including John Campbell (R-CA) and Todd Akin (R-MO), are introducing bills to place a statutory cap on the annual growth in total federal outlays. There are a number of design features that Congress should consider if it imposes such a cap.

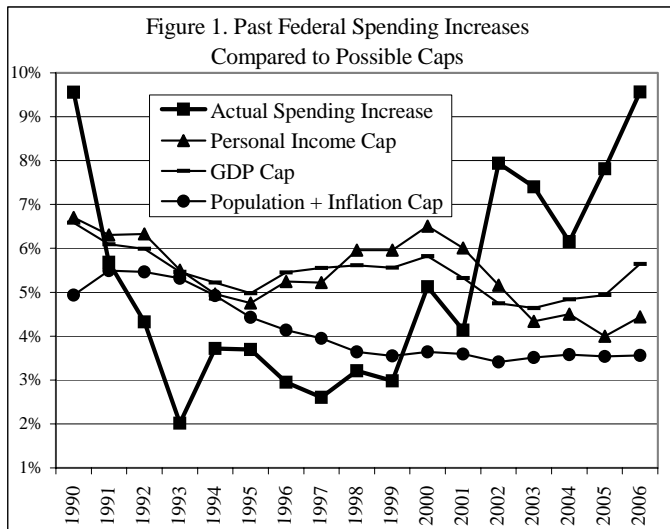
What to Cap. The BEA imposed multiyear caps on discretionary spending, but so-called entitlement spending was not capped. Entitlements, such as Medicare, have been allowed to grow rapidly on automatic pilot, which is pushing the government toward a financial crisis.

Entitlements account for more than half of the budget and should be included under any cap. A cap should be placed on the growth in total federal outlays.

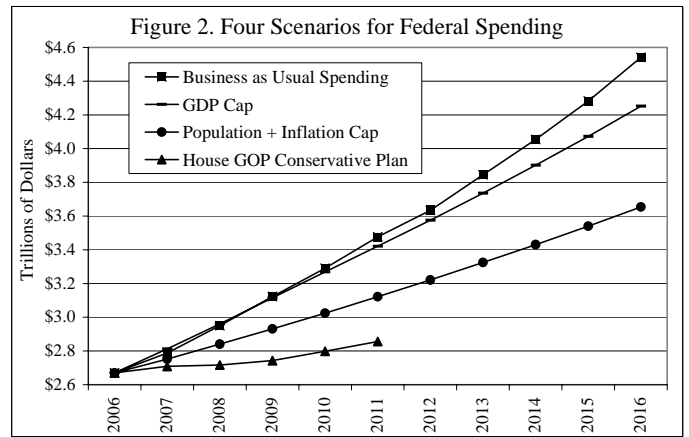
Base of a Cap. A simple way to structure a cap is to limit annual spending growth to the growth in an economic indicator such as gross domestic product or personal income. Another possible cap is the sum of population growth plus inflation. In that case, if population grew at 1 percent and inflation was 3 percent, then federal spending could grow at most by 4 percent. Most people would agree with the principle underlying all of these caps—the government should live within constraints, as average families do, and it should not consume an increasing share of the nation’s income or output.

Figure 1 shows actual federal spending growth since 1990 compared to possible caps. The GDP and income caps would be looser than a cap based on population growth plus inflation. Whichever indicator is used should be smoothed by averaging it over about five years.

Figure 2 shows that any of the caps would constrain spending compared to a business-as-usual scenario.² But the lower population plus inflation cap would be a much safer approach in case politicians treated a cap as a floor for spending increases and ignored the need to proactively cut wasteful programs. All of the caps would provide protection against a nightmare scenario of continued Bush-sized spending increases, but none would guarantee that Congress acted to make the spending cuts needed to halt the ongoing explosion of federal debt. The House Republican conservative plan in Figure 2 illustrates the spending path needed to bring a halt to the debt explosion.³



Source: Author, based on various government data. Spending is fiscal year outlays. 2006 data is estimated. Caps are five-year averages of indicators.



Source: Author. The two cap lines assume that spending would rise each year by the maximum amount allowed.

Cap Procedures. The Office of Management and Budget would provide regular updates regarding whether spending is likely to breach the legal cap, thus allowing Congress time to take corrective actions. If a fiscal year ended and OMB determined that outlays were above the cap, the president would be required to cut spending across-the-board by the percentage needed to meet the cap. GRH and the BEA included sequester mechanisms that covered various portions of the defense, nondefense, and entitlement budgets. A better approach is to cap all spending and subject all departments to a sequester should Congress fail to restrain spending sufficiently.

Conclusions

One shortcoming of a statutory spending cap is that Congress could rewrite the law if it didn’t want to comply with it. However, with a cap in place reformers would have a high-profile symbol of fiscal restraint to rally around and defend. Over time, public awareness and budgetary tradition would aid in the enforcement of a cap.

Policymakers need more than a cap to avert a coming fiscal crisis—they need to scour the budget for programs and agencies to eliminate. But a cap on spending growth would begin to get the budget under control and provide taxpayer insurance against another federal spending orgy.

¹ Michael New, “Proposition 13 and State Budget Limitations: Past Successes and Future Options,” Cato Institute Briefing Paper no. 83, June 19, 2003.

² The business-as-usual scenario assumes that discretionary spending grows with GDP and that entitlement spending grows per the Congressional Budget Office baseline.

³ House Republican Study Committee, “Contract with America: Renewed,” March 8, 2006. See also Chris Edwards, *Downsizing the Federal Government* (Washington: Cato Institute, 2005).