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America's Fiscal Peculiarities

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The government of the United States came within hours of shutting down on April 9. Under American arrangements, government personnel cannot be paid without an appropriation of funds by Congress, the American legislature, which is made up of two houses, a Senate (elected for six-year terms) and a House of Representatives (elected every two years). They cannot even work voluntarily. Without funding, all government employees would have to stay home, except those – such as air traffic controllers – whose jobs involved protection of life or property, but ironically including tax collectors. The Federal Reserve – America's central bank – is an exception, since it is financed by its own earnings.

Under the American constitution, Congress controls the purse. Each February the President proposes his budget for the upcoming fiscal year – which begins on October 1 – but this is just his wishes. Congress, which is not under control of the President, decides. (The President can veto legislation that he does not like, including a budget, but Congress can over-ride his veto with a two-thirds vote in both houses.) This is deliberate, designed by the American founding fathers to assure that not too much power is concentrated in anyone's hands.

The problem arose in April because the US government had no budget for fiscal year 2011, which began on October 1, 2010. When budget appropriations are not passed in time, normal practice is for Congress to pass short-term "continuing resolutions", allowing government agencies to spend at the same rate as in the previous year, but not to make new commitments. Such continuing resolutions this year were challenged by some newly elected Representatives of the Republican Party, which took a majority in the House of Representatives in the regular election of November 2010. They wanted spending rates below those of 2010, and wanted certain expenditures abolished altogether, such as government contributions to National Public Radio, a public/private partnership that broadcasts quality programs. The Senate, still controlled by the Democratic Party, bristled at these unconventional adjustments and refused to agree to them. Hence the budgetary impasse. It was only broken late on April 8 by a compromise. Appropriations for fiscal year 2011 were passed the following week, seven months late, with cuts of \$78 billion.

Congress discovered years ago that it did not have enough time to review large and increasingly complex budget requests in less than six months. In 1976 it changed the beginning of each new fiscal year from July 1 to October 1, giving it three more months to pass a budget. Sadly, in recent years it has rarely passed the budget on time, resulting in the need for continuing resolutions. It insists on annual appropriations (with rare exceptions), yet does not give the budget the legislative priority it requires. Thus the Democrats in congressional leadership are also implicated – they should have managed to pass the 2011 budget well before the November elections of 2010. Focus in early 2011 should have been on the budget for 2012, as it now is; but three months have been squandered. Further delays are all too likely.

Closing the Federal government was not merely hypothetical. It occurred twice briefly in 1995, also following a takeover of the House of Representatives by Republicans after the 1994 elections. Intransigence was led by newly chosen Speaker (the leader of the House of Representatives) Newt Gingrich, who is sometimes mentioned as a possible presidential candidate in 2012. The closures lasted only a few days on each occasion, so severe damage was limited. Still, the Council of Economic Advisers estimated that GDP growth in the fourth quarter of 1995 was reduced by 0.25 to 0.5 percentage points. Gingrich's reputation was also damaged with the public, and Republicans suffered in the 1996 election.

There are two reasons, apart from the brevity, that the shutdown of the government was less important than it might have been in many other countries. First, Federal government spending, at 20 percent of GDP in 1995, up to 25 percent by 2011, is lower than it is in other rich countries. More important, the fifty US states as constitutionally sovereign entities continued to function during the shutdown of the Federal government, except for programs that were financed by the Federal government – and even those could be continued insofar as the states could borrow or draw down their assets to cover the expenditures. For example, school teachers are employees of each state (or their sub-divisions), not of the Federal government; the schools could continue to run throughout the shutdowns.

Conflict over the budget has not been resolved, only postponed. House Republicans want major cuts in government medical expenditures for the poor and the aged, and insist that taxes should not be increased. Democrats want to protect the substance of medical expenditures (all agree that the efficiency of the programs could be increased) and other welfare programs, if necessary by raising taxes on people with high incomes. This will be fought out over the budget for 2012 and subsequent years, and will no doubt play a major role in the elections of 2012.

In the meantime, there will be another occasion for a Congressional impasse. There is a statutory ceiling (of \$14.3 trillion) on the Federal government debt. With a continuing need to borrow to cover an ongoing budget deficit, that ceiling will be reached sometime in the summer. Again, this issue has arisen on many occasions in the past, and has been resolved by the simple expedient of raising the ceiling, which Congress has the authority to do. Some Republican congressmen have pledged to oppose raising the ceiling unless President Obama and the Senate agree to significant further cuts in government expenditures. Without a rise in the ceiling, the government would have to curtail expenditures drastically, although not literally shut down. Thus we can expect further political drama in a couple of months.

None of this seriously addresses the issue of reducing the deficit and the debt growth held by the public over the longer term. This will be the subject of a later column.