FEDERAL BUDGET PROCESS REFORM: An Economic Perspective

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An early version of this paper was presented at the 2020 Meetings of the Southern Economics Association, Virtual Session on “Federal Fiscal Challenges,” 1 November 21.

“The fish will be the last to discover water.” Anonymous.

Abstract: The current federal budget process lacks the singular element that gives meaning and motivation to budgeting and economic analysis: the concept of scarcity. The effective operating assumption of the activity we now call federal “budgeting” is that the rest of the world will provide us with unlimited resources in exchange for US Treasury debt. Accordingly, for federal ‘budget’ decisions, choice is unnecessary, opportunity costs are zero, and allocative efficiency is passe. Even those analysts who warn of harm from a national budgeting process without scarcity usually focus on its adverse effects on economic growth and an elevated risk of fiscal, economic, social, and political instability. In fact, the continuous loss from suboptimal resource allocation is arguably as great. This paper offers an outline of events leading to the end of scarcity and a proposed process change to restore the missing element and improve federal budget decisions. (146 words)

INTRODUCTION

With economics and true budgeting: it’s all about scarcity.

Microeconomics is the study of how people do the best they can with resources that are scarce in relation to their beneficial uses, i.e. engage in the process of “constrained optimization.” Budgeting is a means of disciplining and informing

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1 I thank the participants in the 2020 SEA Session, especially my discussant, Barry Poulson, for helpful comments and suggestions.
necessary choice consistent with the goal of the maximum benefit from limited resources. Addressing scarcity is the general activity; budgeting a specific instance. Markets and government are social institutions commonly used to minimize the adverse consequences of scarcity. Microeconomics provides a conceptual solution to the optimization problem for both: allocate scarce resources to alternative uses until the marginal benefit from each alternative is equal, or until marginal opportunity cost equals marginal benefit.

Given universal scarcity and the unique power to compel, governments must make two distinct types of allocative decisions: among alternative governmental uses of resources and between public and private choice, i.e. between market and government allocation. For intra-governmental allocative decisions, policy makers must compare the costs and benefits of alternative public uses of funds. For public-private trade-offs and settling on the “right size” of government, the traditional rubric is to limit government’s claim on resources to the inferred value of government services. That is, to amounts constituents are willing to pay.

For the first 150 years of so, US government budgeting was governed by the “balanced budget norm,”: spending more than current revenues was acceptable during times of economic or defense emergency, conditional on retirement of the debt issued after the emergency had passed. (Figure 1). Beginning in the 1960’s, however, the balanced budget norm was gradually replaced by a new orthodoxy: when resources are unemployed, borrowing (issuing Treasury debt) is a long-term alternative to increasing taxes or reducing other spending to finance new government spending. The underlying rationale, part of the new Keynesian macroeconomic paradigm, was that increased total spending, without increasing tax rates, would increase aggregate demand for goods and services, thereby increasing the demand for idle resources including unemployed labor. The increase in employment and income would raise tax revenues and reduce outlays for public assistance. In prospect, the increase in spending could be self-financing and “pay for itself.”

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2 Both, of course, are imperfect. Much of economics is aimed at improving the performance by criteria of both.  
3 Government’s power to compel payment of taxes and to impose other restrictions on private choice creates the potential for government to increase the efficiency of private choice in the presence of “market failures,” e.g. externalities, public goods, insufficiently competitive markets, asymmetric information, assignment and enforcement of property rights and contracts, a socially undesired distribution of resources among constituents. However, net gains from those intervention result only so long as marginal social benefits exceed social cost.
The existence of unemployed resources thus seems to offer relief from the “dismal” implication of scarcity: we can have more of one good or service only if we give up something else of value, or if we bear its opportunity cost. In its vernacular form: “there is no such thing as a free lunch.” Under the new approach, additional government spending in the presence of unemployed resources could provide benefits to the public without the necessity of giving up something else of value. Moreover, some resources almost always seem to be unemployed for reasons that may have nothing to do with weak aggregate demand.⁴

The new view eventually proved popular with policymakers and their constituents. It remains the dominant policy heuristic for federal finance today. Nonetheless, the new norm—in the presence of a seemingly inexhaustible demand for US Treasury debt—has had the adverse effect of obviating the need for allocative decisions that produce net social benefits. In the process, it appears for have blinded policymakers to the gains that can be realized from making efficient budget choices: policy and budget changes for which expected benefits exceed opportunity cost can be structured to distribute costs and benefits to make everyone better off without making anyone worse off; that is to produce a Pareto optimal result. Win/win policies are achievable even in a world of scarcity. But the policies must be structured to share the gains among all, including those sitting across the political aisle from the majority.

This paper offers an explication of how a strictly limited but correct macro-economic insight became the gateway to a transformation of federal budgeting into its enduring antithesis. It also offers a proposal for a budget process change that could restore the socially useful functions of budgeting while retaining appropriate use of the insight that fiscal policy has the potential to add social value by reducing cyclical unemployment.

⁴ Walter Oi, famed Professor of Economics at the University of Rochester and major contributor to the case for an all-volunteer military force is said to have replied to a reporter’s question as to whether the US had finally reached full employment with: “No, I don’t think so,” while gesturing toward acres of lawn outside his office. “Look at all that grass, and no sheep.”
Figure 1: US Treasury Debt Held by the Public, (% of GDP), 1793 - 2049

[Also available in Merrifield and Poulson (2017), p. 63.]

PUBLIC BUDGETING: An Economic Perspective

True budgeting and economics exist because of scarcity; without scarcity they lack purpose and function. This existential condition implies that a process for making spending decisions must recognize the reality of scarcity and its implications. Absent scarcity, benefits are free of opportunity cost. More can be had of everything without giving up something else of value. In those circumstances, people rationally demand every government service to satiety, until marginal benefit is zero. In fact, the absence of scarcity appears to be the only condition in which, when uncertain, it is always better to err on the side of getting too much rather than too little. Without scarcity, Medicare for all dominates Medicare for those who require assistance. Universal, complete student loan forgiveness is preferred to anything less. Expanded Social Security benefits, paid leave, and a living wage for all is the rational, preferred choice over more limited policies. If additional spending for defense provides any social benefit, it should be undertaken. Tax cuts are always to be favored over current or higher levies.

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5 An economic interpretation of budgeting is sometimes dismissed as irrelevant to the design of effective budget processes because budgeting has many other purposes of equal social importance to scarcity-constrained optimization. (Khan and Hildreth. 2002 provide a summary.) Principal among those multiple functions is to resolve conflict among important constituencies. However, scarcity is the principal source of that conflict. The failing of the current budget process is that it resolves conflict in large part by shifting costs to the future rather than by weighing the trade-offs and benefits of alternative resolutions.

6 To be completely clear, the embrace of unconstrained budgeting is bipartisan. We live in an era of the Two-Santas (Wanniski 1976) with each providing “gifts” of increased government spending or reduced taxes that are more accurately characterized as “loans.” (Steuerle 2018)
Instead of scarcity, the current federal fiscal decisionmaking process starts focused on “stimulus.” The highest fiscal priority seems to be to maximize jobs and economic activity, as if scarcity applies only and perpetually to the beneficial uses of resources. To be sure, resource use is subject to cyclical variation in demand, often partly offset by changes in monetary and fiscal policy. But intensity of resource use at any time is also subject to variation for reasons—adjustment to changes in tastes, technology, or relative prices—other than changes in aggregate demand. Using demand stimulus to attack unemployment from all causes reduces the resilience and dynamism of markets and imposes inefficiency and dead weight losses on society.

The notion that borrowing is always better than tax increases and spending cuts as a means of financing is a good example of Bastiat’s well-known (to ECON students) Broken Window Fallacy. The original 1850 Bastiat essay uses the incident of an errant stone breaking the window in a baker’s shop to debunk the false view that destruction of existing assets can produce net benefits because it leads to a rise in the demand for labor and goods required for its repair or replacement. This in turn increases the number of jobs, income, and additional spending and creates a virtuous spiral of greater prosperity for all. Bastiat emphasizes, however, that the claim of net gain ignores the (unseen) net value that would have been obtained if the requisite resources had been employed in other productive uses rather than in replacing an existing asset. That is, the fallacy arises from ignoring the unseen alternative use of those same resources in producing higher value goods and services—the opportunity cost of replacing the broken window. Borrowing to finance an increase in consumption today similarly produces obvious, immediate benefits, but at a cost that seems negligible today, but amounts to an equal sacrifice of future value. Borrowing merely defers some of the cost to another time.

Nonetheless, the past 50 years of US fiscal policy have been characterized by the gradual disappearance of fiscal balance, scarcity, and opportunity cost as a policy consideration of US Federal policymakers. This development has been documented by others, including Merrifield and Poulson (2017), Chapter IV. Historians of economic thought generally attribute this change to the Keynesian Revolution that swept away the balanced budget norm and replaced it with a focus on using government budget deficits to maintain high employment in market economies.

7 "Ce qu’on voit et ce qu’on ne voit pas" ("What is seen and what is not seen"). Bastiat essay introduced, through the parable of the broken window, the concept of opportunity cost in all but name." Wikipedia.
For our purposes, it is important to note that the revolutionary contribution of the new Keynesian paradigm was not that debt-financed spending was useful during recessions, a practice consistent with the balanced budget norm, but rather that debt financing could produce social gains during good times, if resources are idle.

In providing policymakers with a new approach for addressing scarcity, the “new” macroeconomics asserted the absence of necessity to making tradeoffs between beneficial alternatives. But loss of necessity of choice among alternatives, based on their respective opportunity costs and social benefits, doesn’t eliminate the cost, and it imposes large and continuous deadweight losses on society. Because those losses are “unseen,” there is little constituency for remedy.

Introspection and the results of systematic behavioral research explain the embrace of the Broken Window fallacy and the displacement of allocative efficiency decisions by stimulus. People are not the fully informed, completely rational calculating *homo economicus* automatons. Rather, they are humans with preferences, cognitive limitations, and irrationalities affecting their policy choices [Thaler and Sunstein, 2007]. They also prefer easier choices (those without visible opportunity cost or tradeoffs) to more difficult ones. Deciding how much to increase spending or cut taxes is an easier call than how much to increase taxes now or reduce spending on a low-value use to increase spending on a higher-value use, if only because the latter harms the uncompensated owner of capital specialized to the low-value use.

Further, elected policy makers choose their agendas and are their own decision process architects; that is, which decisions they will choose to make and how they will make them (Meyers. 1999) The Keynesian Revolution offered democratic policymakers an opportunity to define their primary role in a manner that enabled them to make much easier decisions, consistent with their own re-electability. Similarly, it seems unlikely that policymakers would choose to restore allocative efficiency to the major goals of budget policy. The brief review of process changes presented below provides some evidence that when the opportunity to do so has arisen, legislators especially have declined to enact limitations on their discretion or have abandoned them before they became effective or constraining on decisions.

**GETTING TO NOW: Key Steps in the Creation of Current Budget Practices**

The Budget and Accounting Act of 1921 is usually considered to be the beginning of the modern federal budget process. Prompted by the surge in spending and the
federal debt during World War I and the 1918-19 influenza pandemic, the Act required the President to develop and send to Congress a comprehensive budget plan for the upcoming fiscal year that would encompass all the fiscal activities of federal executive agencies (Schick 2007). The guiding idea was that the budget totals, especially deficits and debt, should be monitored and managed by the Executive, who could be held more accountable for the government’s fiscal condition than an amorphous, parochial legislature. To assist the President in this effort, the Act created the Bureau of the Budget, predecessor of the Office of Management and Budget (OMB). In addition, the Act created the General Accounting Office (GAO) to audit the financial performance of agencies and provide assurance to the Congress and the public of their adherence to statute and Congressional direction. The legislation significantly increased the ability of the President to affect budget decisions through the acquisition and use of information and in shaping the budget policy agenda.⁸ For 40 years following the 1921 Act, the Balanced Budget norm continued to govern aggregate fiscal policy.

The Kennedy Administration in 1961 was the first to embrace the new Keynesian orthodoxy and argue that reductions in taxes, increases in federal spending, and larger deficits could increase employment, production, income, and economic growth, even in the absence of a recession. When Lyndon Johnson succeeded Kennedy in 1963, he continued the push for expansive aggregate demand policies, launched the War on Poverty, and escalated the Viet Nam War.

Professional concerns about the potential for inflation in a booming economy and the inadequacies of current budgetary accounting and reporting for effective macro-management of the economy led President Johnson to appoint a Commission on Budget Concepts to make recommendations for improving the government’s ability to manage the macro-economy. The Commission focused especially on 1) reducing prevailing confusion among the public and policymakers arising from three different federal “budget”: Administrative, Consolidated Cash, and National Income Accounts budgets, each with different bottom line spending and deficit measures; 2.) adopting accrual accounting for federal orders of durable goods, especially military hardware, to match budget recognition with obligational stimulus; and 3) creating fiscal “space” for two Wars by reducing the overstated, cash-basis cost of direct federal lending.

⁸ (Schick 2007) refers to the period 1921-74 as an era of “presidential dominance.”
The Report of the 1967 Commission facilitated the shift in budget priorities toward macro-economic management. It also remains an authoritative reference for budgetary accounting standards among federal budget practitioners today. The Report addressed its key issues with the following recommendations:

- **Multiple “budgets”:** adopt a single, unified budget display, comprehensive of the use of federal fiscal resources, to measure the total federal effect on aggregate demand in the current year.
- **Cash-basis accounting:** replace this measure of the G component of aggregate demand, especially for military hardware and transportation equipment with an obligational, accrual basis of budgetary accounting. Similarly, reject proposals for adoption of a capital budget on grounds that it would further delay the recognition of budget spending past their point of macro-economic effect.
- **Fiscal “space”:** move Fannie Mae and its cash-basis direct lending off-budget by converting it to a privately-owned GSE (government sponsored enterprise), following the example of the Federal Land Bank, Farm Credit System. This accounting treatment was also adopted for Freddie Mac at its creation in 1970. Also replace cash-basis of accounting with accrual accounting for the budget subsidy cost of direct loans advanced by remaining on-budget credit agencies.

OMB adopted the Commission’s recommendations for a single, consolidated budget, against a capital budget, for and moving Fannie Mae off-budget. It increased the visibility of “unfilled orders” for durable equipment but retained cash-basis accounting for purchases of goods and services and for on-budget federal loan programs.⁹

**CONGRESSIONAL CONCERNS ABOUT THE BUDGET PROCESS**

Persistent 1960s deficits required frequent, discomforting Congressional approval of increases in the federal debt ceiling. Escalating debt also enabled President Nixon to enjoy considerable success in tarring Congress as “fiscally irresponsible,” and thus justifying his practice of impounding (refusing to spend) amounts appropriated for programs he opposed. He also challenged the Congress to honor the debt ceiling in his annual budget proposal. Joyce (2011) identified the FY 1973 budget as pivotal in

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⁹ Federal direct loans and loan guarantees were converted to an accrual-basis of accounting for subsidy costs in the Federal Credit Reform Act, a title of the Budget Enforcement Act of 1990.
the inter-branch struggle to control federal spending. That year, the President demanded that the Congress adopt a $250 billion cap on federal outlays. Both houses passed legislation to establish that limit, but the effort failed in conference. That failure highlighted the lack of a process for Congress to control total spending despite the constitutional grant of power of the purse to the legislative branch.

The loss of Congressional control of spending was largely due to the rapid growth in mandatory programs such as Social Security, Medicare, and Medicaid whose spending is not limited by annual appropriations. By 1974, mandatory accounted for about half of federal outlays. Thus, the House and Senate Appropriations Committees, historically seen as the Congressional guardians of spending restraint, had gradually lost control of total federal outlays leaving the legislature without a Committee with jurisdiction over total budget spending. Together, both political forces and structural weakness in the process set the stage for the development and enactment of the Congressional Budget Act.

**Congressional Budget and Impoundment Control Act of 1974**

This Act created a budget process with a legislatively-established constraint, multiple provisions for enforcement, and fiscal flexibility to address economic and defense emergencies. As Philip Joyce documents in his definitive 2011 study of the founding, development, and organization of the Congressional Budget Office, Congress wanted something approaching parity with the President in making national fiscal policy. That meant they needed: a macro-economic analytical support capability equivalent to OMB, an entity to develop policy and enforce it across the decentralized Congressional Committee structure, and a legislative vehicle to specify the Congressional fiscal plan. Their aim was to gain control over fiscal policy, not to change the nature of federal budgeting. The 1974 Act met their objectives with the establishment of the Congressional Budget Office (CBO), the Budget Committees, and the Congressional Budget Resolution, respectively.\

The Budget Act also included procedures for enforcing the budget resolution within the Congress. The two most important were points of order and reconciliation. The first created a point of order against the consideration of a bill that would violate

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10 In one sense, they got more than many in the House wanted, especially from CBO. Joyce (2011), Ch. 2 details the preference of some for a narrowly focused support agency that would 1) project budget and economic conditions under alternative fiscal policies and 2) score legislation against the Budget Resolution. He also explains how Alice Rivlin, CBO’s first Director, with the support of Senator Muskie and the Senate Budget Committee, was able to broaden CBO’s budget mission to include program evaluation or, “program analysis,” as it was then described.
the adopted limits. Reconciliation gave the Budget Committees authority to require Committees of jurisdiction to report legislation that would reduce spending or raise revenues sufficient to meet Resolution targets. However, those enforcement measures and the Budget Resolution itself are not law but rather are incorporated into the procedural rules of both Houses, which are themselves subject to change at the discretion of a majority of members. Over time, especially in the House, it has become routine for points of order to be waived, often by the Rules Committee if the offending legislation has the backing of the majority leadership.

Similarly, while Reconciliation, which receives expedited consideration in both Houses, was used by the Reagan Administration to cut spending, it is now used primarily to adopt policies that increase spending or cut taxes. Examples include the $1.5 trillion tax cut enacted by the Republican majority for FY 2018, to revise the Affordable Care Act, and to enact a $1.9 trillion COVID relief, bailout, and stimulus package during the early days of the Biden Administration. (Hoagland 2021)

**Legislative Revisions of the 1974 Congressional Budget Act**

Continued deficits under the new process led to enactment of Gramm-Rudman-Hollings Balanced Budget and Emergency Deficit Control Act of 1985 (GRH) which specified sharp reductions in annual deficit limits that were to be enforced by across-the-board percent reductions is outlays, or sequestration, if these targets were not met through legislated changes in law. The Congress, however, subsequently proved unwilling to make the necessary policy modifications or to permit the sequesters to reach GRH targets.

The failure of GRH to achieve the intended fiscal result, led the Congress and the President to agree on a new approach to fiscal restraint, enacted as the Budget Enforcement Act of 1990 (BEA) that set 5-year caps on discretionary spending and a PAYGO scorecard capping annual net legislated increases in mandatory spending and reductions in taxes at zero. Both the discretionary ceilings and PAYGO balanced scorecard were to be enforced by sequesters.

BEA enjoyed some initial success: the discretionary caps and PAYGO rule were honored, for 5 years, without significant sequestration and modest amounts of “creative” budgetary accounting. But when BEA expired, it was replaced by a new version of PAYGO with many program exemptions. It has had little effect on restraining legislated spending increases or tax cuts.
As a result of this experience, many observers have concluded that adoption and enforcement of a disciplining, controlling limit will require the involvement of an extraordinary economic or political event. It is not possible to anticipate precisely when a Black Swan might appear and provide this force. But given the unsustainable path of the current process and the sage insight of Herbert Stein (“If something cannot go on forever, it will stop”), it seems reasonable to consider the outline of a revised process that might be useful in such an eventuality.

IDENTIFYING A FEASIBLE, EFFECTIVE REFORM: A CED/Smithies Proposal Redux

Behavioral research and experience with several budget process innovations suggests that modifications more likely to be successful in re-introducing scarcity to budgeting are themselves subject to certain political, economic, and behavioral requirements. The new process should be acceptable to the Congress so that they enact and live with it. The new constraint should be intuitive, related to scarcity, and easy to understand. Enforcement should be prospective—not ex post—and automatic, without requiring action (heroic or routine) by members or major losses to their important constituencies. Fiscal emergencies should be anticipated and included in budget plans, ex ante.

Though this paper’s emphasis on the loss of scarcity as the key failing of the current process may seem odd or eccentric, the risk that stimulus would crowd out stability and efficiency as fiscal policy objectives was already seen as sufficiently high in the 1950s that academics and public policy associations broadly addressed it then. For example, that was an extensive part of Arthur Smithies’ (Chair of the Economics Department at Harvard) 1955 overview and critique of the federal budget process, published by the Committee for Economic Development (CED). Smithies, in support of an earlier CED proposal for a “stabilizing budget,” argued that national budgeting could advance efficiency in resource allocation through choices based on the costs and benefits of alternatives, while simultaneously moderating fluctuations in income and employment. To facilitate that result, he endorsed the CED recommendations that: 1) federal annual spending be limited to the estimated level of annual federal revenues under current law at high employment and 2) the federal budget be augmented by a “special budget,” essentially a budget stabilization fund, to finance and budget for fiscal responses to economic, defense, and natural emergencies.11

11 State experience with balanced budget rules and rainy-day funds also suggests the potential usefulness of that combination of structural elements (Hou and Duncombe 2008).
(Smithies 1955: 443-450). For the federal government, those process modifications could have restored the fiscal discipline and retained the budget flexibility of the “balanced budget norm.” The budget process was to be constrained by scarcity, but intertemporal, offsetting imbalances were to be facilitated.

The CED/Smithies proposal remains an attractive, if largely neglected option. Its principal advantage is that it reconciles the appearance of conflict between the efficiency gains from a fiscal constraint and the flexibility required for economic stabilization. Formulating the constraint in terms of high employment revenues has an advantage over a strict balanced budget rule because it avoids pro-cyclical changes in policy during economic slowdowns and booms. The proposal also relies on the amounts people are willing to pay for government services in good times to determine the “right” fiscal size of government. The Smithies/CED proposal is also consistent with recent research findings (Anderson and Minarik 2006; Merrifield and Poulson 2019), and with GRH experience and the federal debt limit that spending constraints are more effective that debt limits, even if the objective is to reduce the growth of debt. One reason for that superiority is that borrowing occurs too late in the process to control directly without the necessity of defaulting on firm obligations (Phaup 2019). The same reason explains the utter failure of the debt ceiling to restrain debt growth. The debt growth controls the debt ceiling (CRFB 2019).

Under current federal budget policy, every major negative shock is treated as an unpredictable surprise that could not have been anticipated and for which the only possible course of action is to borrow to finance an essential response. True perhaps for specific instances, but the periodic occurrence of shocks is as predictable as the seasons. Rational policies in a world of scarcity anticipate those events and act to smooth consumption before they occur. The Smithies proposal addresses that need with the creation of a budget stabilization fund to isolate the fiscal costs of “extraordinary” policy measures from the rest of the budget. This separation has two advantages: first, to free those responses, temporarily, from the expected revenue constraint but, second, to monitor account balances and assure that extraordinary departures from fiscal balance are offset with revenues collected in good times.

12 The 1967 Report of the President’s Commission on Budget Concepts (p. 14) identifies the basic purposes of budgeting as “resource allocation and economic stabilization” and refers to these functions as “interdependencies.”
Under more recent accounting practices, a budget process could achieve the desired bifurcation, sustain budget comprehensiveness and discipline by placing a “stability budget” account below-the-deficit line, technically in the “means of financing the deficit other than borrowing from the public.”\textsuperscript{13} Such accounting would also lend itself to a policy of \textit{ex ante} accrual budgeting for the expected annual emergency costs and create incentives for mitigation and avoidance of losses if doing so would be more efficient and effective than relief and remediation (Phaup and Kirschner 2010). It could also prevent the upward ratchet in debt caused by repetitive adverse macro-economic shocks, each of which is currently seen largely as a fiscal “surprise.”

This proposal’s appeal can be further enhanced by adding operational detail consistent with later, successful budget process innovations and with advances in understanding the crucial role of process in affecting decisions. (Kahneman 2007; Thayer and Sunstein 2008; Thayer 2015; and sources cited therein).

One finding of behavioral research particularly relevant to budget process reform is that making better decisions \textit{easier}, cognitively and physically, will increase the frequency of better decisions—those more consistent with long-term preferences and well-being. To successfully reestablish a federal budget process by reintroducing scarcity, we must make better budget choices “easier” on cognitive effort and energy, and without routinely requiring heroic personal sacrifice.\textsuperscript{14}

As recent experience demonstrates, ease of decision making can be facilitated by simplifying the process, delegating the task of analysis to analysts, providing key information in a salient form, using no-decision default options consistent with social objectives, and planning routinely for adverse events (Phaup 2019b). For instance, adopting expected high employment revenues as a budget constraint would shift the current technical burden of determining “how much” to spend each fiscal year consistent with fiscal sustainability from policymakers to analysts at OMB and CBO, a task for which the former are poorly suited. That change would

\textsuperscript{13} Accounts in this part of the budget are used for a variety of purposes including showing the effect of changes in Treasury cash balances on the Treasury borrowing requirement, to record federal obligations and claims on an accrual-basis of accounting rather than a cash basis, e.g. interest on Treasury debt is recorded as earned by transfer from Treasury to an interest payable account where it is held until paid to debt holders. Other accounts included in this budget tabulation include expected outlays for loans guaranteed by the federal government, and other amounts payable.

\textsuperscript{14} This concept contrasts with an alternative strategy of advising policymakers to “just do it!” A similar “solution,” electing officials willing to make “hard choices,” is wishing for super-human heroes, who are already fully occupied saving other imaginary worlds.
significantly simplify the task of budgeting for elected officials, who would retain the functionally appropriate task of deciding “on-what” to spend. That shift in focus could also increase the demand for performance information useful in identifying policies most effective and efficient in achieving social goals.

Smithies and the CED also advocated greater use of automatic stabilizers such as the progressive income tax and mandatory public assistance programs to reduce lags in stabilizing fiscal policy by avoiding some discrete budget decisions. From a behavioral perspective, those policy instruments also harness the power of pre-commitment and permit balanced responses to be devised and enacted prior to loss and in the absence of an emotional inclination to deliver assistance to those in need, without regard to its cost. Use of these policies could be substantially increased. One current proposal to create an additional, automatic, targeted macro-policy response to economic downturns would create a federal fiscal insurance program for states (Burman, Gordon, and Ari 2021).

Perhaps the biggest obstacle to the addition of an effective federal budget constraint is the difficulty of assuring its enforcement. The Smithies/CED proposal, as supplemented with the operational detail described here, has some potential to reduce this hurdle via automatic and prospective adjustment in funds available for new spending. The key to this advantage is the treatment of the budget stabilization fund as the federal government’s self-insurance fund against adverse fiscal events (Bhatti and Phaup 2015). The technical task of calculating annual premiums for stabilization insurance would be the natural province of a semi-independent fiscal authority such as CBO. Estimates of resources necessary to offset expected losses could be protected from Congressional “time inconsistency” by statutory classification of fiscal insurance premiums as mandatory; that is, obligated annually without further legislative action. Treasury would be authorized to transfer those sums annually from the general fund to the stabilization fund. Consistent with the classification of the budget stabilization fund as below-the-deficit-line, those transfers would be scored in the budget as outlays and available to finance anticipated fiscal shortfalls that would otherwise necessitate an equal amount of borrowing from the public. As with any other expenditure, government’s insurance premiums would count against the annual expected revenue cap on spending.

15 Technically these could be treated as either direct spending authorized in the enabling statute or as funded with permanent, indefinite budget authority.
For financial adequacy, annual insurance payments would need to be adjusted for actual annual budget shortfalls. Systematic overspending of expected annual revenues, from all causes, would trigger automatic increases in estimated premiums and tighten the constraint prospectively in future budgets. The estimated expected annual cost might also be expected to rise with such variables as climate change, population growth, and increased international instability.

**PLANNING A TRANSITION**

The current financial condition of the US government is the result of more than 50 years of unconstrained fiscal policy and many “surprise” fiscal emergencies. In COV-free FY 2019, the federal deficit was just short of $1 trillion, meaning that Treasury had to borrow 22 cents for every dollar the government spent that year. Further, more than 90 percent of the revenues collected in the fiscal year were already obligated for mandatory programs and interest expense. So, it is unlikely and probably undesirable for policymakers to quickly adopt and adjust to the CED-Smithies constraint. Instead, reform might do better to plan for a significant transition period that can be sustained until meaningful fiscal balance is restored. That might entail 10 years or so of gradual adjustment, but with initial, small but painful, “down payments” that could be described as “wasted sacrifice” to restrain the impulse to abandon the transition plan.

Successful transition also might be facilitated through policy changes that are adopted immediately but become effective in the future in small increments. Examples include monthly increases in eligibility age for retirement benefits and others that require commitment now to increase retirement contributions in the future, coincident with increases in pay, or “Save More Tomorrow” (Thaler 2015).

**CONCLUDING COMMENTS**

The current federal budget process lacks a functionally essential element for allocative choice and constrained optimization: recognition of scarcity. Without scarcity, the opportunity cost of every beneficial policy is zero; the broken window

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16 The unobligated and available 10% is the Steuerle-Roepen Fiscal Democracy Index, which measures the fiscal freedom of current policymakers to allocate resources to current priorities (Steuerle. 2014).
fallacy and the perpetual goal of “stimulus” become the effective decision rule for budgeting. Seeking more efficient or effective budget options is pointless.

Scarcity began to fade from public fiscal consciousness in the 1960s during the Kennedy-Johnson Administration with the rise of aggregate demand management, especially “stimulus” as the economic elixir of choice. Concurrently, federal budget deficits became more persistent. Today, scarcity has no more presence in federal fiscal or budget decisions, than the smile of a Cheshire Cat.

Because budgeting is without purpose or function in the absence of scarcity, describing its condition as “broken” suggests a blindness to the pervasive ambient. Currently proposed budget process reforms may increase budget “activity,” but are unlikely to have much social benefit until this essential element is restored. Although there are numerous process changes that could effect that result, this paper offers a reconsideration of Arthur Smithies’ 1955 proposal, consistent with both macro stabilization and micro efficiency.

Successful reintroduction of the concept of scarcity into federal budgeting is necessary, but likely not sufficient, to significantly improve the alignment of budget decisions with the goal of allocative efficiency. Current cash-basis budgetary cost accounting, incomplete coverage including tax expenditures, and inadequate measures of performance are inconsistent with the objectives of efficiency, stability, and equity. But adding a constraint is an essential first step because budgeting without scarcity is without purpose or function.

References:


17 Topical examples include slogans used in support of a large, untargeted COVID-19 relief measure and to reduce remaining budget process speedbumps. “Go big, or go home!”; “Erring on the side of too much help is preferable to too little when people are struggling”; “Ease the Byrd Rule on reconciliation.”

Committee for a Responsible Federal Budget (CRFB). 2019. “Everything You Should Know about the Debt Ceiling,” February 27, Papers, Washington, D.C. Q&A: Everything You Should Know About the Debt Ceiling | Committee for a Responsible Federal Budget (crfb.org)


