Demystifying the Federal Budget Process

Executive Summary
Understanding the federal budget process has grown in importance for financial market participants, particularly when fiscal policy takes a front-and-center approach as it has in the past several months. This can prove to be a daunting task, however, as the process by which policymakers determine the nearly $4 trillion in spending and tax collections each year is fraught with confusing jargon, procedures and problems that seem to come and go at random. In this report, we develop a short reference guide to help our readers cut through the noise and better understand the federal budget process.

We begin with an overview of the normal federal budget process as it is supposed to occur and discuss some alternative paths and procedures by which policymakers can keep the government funded when disagreements or challenges arise. We then turn to a discussion of the nation’s debt ceiling and its role in the budget process. Finally, we tackle a topic that arises frequently in our conversations with clients—budget reconciliation.

The Federal Budget Process: How It’s Supposed to Work
First, we believe it is useful to walk our readers through how the process is supposed to work.¹ In reality, policymakers often deviate from this route, and we will discuss some of the most common deviations in the next section. The process starts in the executive branch, as federal agencies and the Office of Management and Budget (OMB) begin planning for the upcoming fiscal year and start maneuvering to make their voices heard. These machinations behind the scenes eventually culminate in the single report known as the president’s budget.² If on time, the president sends the proposed budget to Congress by the first Monday in February. There is no penalty for missing the deadline, and presidents frequently send their budgets to Congress late. Perhaps the most important takeaway from this step is that the president’s budget is not binding. The president’s budget simply reflects what the executive branch believes is the appropriate level and distribution of funding based on White House policy priorities and political goals. Still, given Congress’ limited time and the vast scope of federal programs and agencies, the nitty gritty details of the president’s budget can still influence the budget process simply through political inertia.

Around late January/early February, the Congressional Budget Office (CBO), an independent agency that provides Congress with budgetary and economic estimates, releases its annual report on the budget and economic outlook over the next decade.³ Using this information, and by conducting a series of hearings, Congress works on developing its own budget, called a budget resolution. The budget resolution can be thought of as a guiding document that determines high-level policies, such as the level of aggregate funding and how this funding should be broadly allocated. In theory, both chambers of Congress craft a budget resolution; once the House and Senate have each passed one, a conference committee convenes between the two chambers to

¹ The Congressional Budget Act of 1974 provides much of the framework for today’s federal budget process. A link to the bill can be found here http://legcounsel.house.gov/Comps/BUDGET.pdf.
² The president’s budget for FY 2018 can be found here https://www.whitehouse.gov/omb/budget
work out any differences. The resulting single bill is then voted on and passed by both the House and the Senate.

**Figure 1**

The budget resolution plays a key role in reconciliation and charting the course for the appropriations process.

It is important to remember that the appropriations process is for discretionary spending.

The budget resolution is one of the more strange facets of the federal budget process. The budget resolution is legally a concurrent resolution, meaning it is not signed by the president and does not have the force of law. As a result, in some years neither chamber will pass a budget resolution, only one will, or both chambers will pass one but they will not come to an agreement between them. In a sense, the budget resolution is almost like the president’s budget in that it should often be viewed as more of a statement of policy goals than to be taken as law. However, when adopted, the budget resolution plays a key role in charting the course for the appropriations process. Furthermore, the budget resolution can become a hot topic for one important reason: it is at this step in the process that policymakers must decide if they want to use a powerful budgetary tool known as reconciliation. We will delve deeper into reconciliation in a later section.

After Congress has presumably painted the broad strokes of the budget, the process turns to actually appropriating the money to the various federal government agencies and initiatives. The aggregate funding is divided among the 12 appropriation subcommittees, and these subcommittees then determine what will and will not be funded within their jurisdiction. These subcommittees then produce 12 appropriations bills which, when advanced out of committee, must pass in both the House and the Senate before proceeding to the president’s desk for signature. If all goes according to plan, each of these 12 individual bills is passed in each chamber of Congress and signed into law by the president prior to the beginning of the next federal fiscal year, which begins on October 1.

As a final note, it is important to remember that the appropriations process is for discretionary spending, or spending that must be set each year by lawmakers. Examples include defense spending, foreign aid and spending on most government agencies, such as the U.S. Department of Commerce or the Environmental Protection Agency. Discretionary spending accounted for just 31 percent of all federal spending in FY 2016 (Figure 2). This differs from mandatory spending, such as spending on federal healthcare programs, which is determined based on eligibility requirements such as age or income. In order to change spending for most mandatory spending, Congress must alter the formula for how this spending occurs rather than annually dictating how much is to be spent.

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4 The full list of appropriations subcommittees can be found at the following links:
https://appropriations.house.gov/subcommittees/
https://www.appropriations.senate.gov/subcommittees
Things Do Not Always Operate Smoothly: Alternative Options

While there is a clearly defined budget process, rarely does the actual legislative process follow this clear path. In fact, the process as outlined above is actually quite unusual in modern times. According to the Congressional Research Service, the last time the budget process was completed by passing all 12 appropriations bills on time was fiscal year 1997. When Congress fails to produce a budget on time, there are two main tools in its arsenal to keep the federal government running in the absence of regular appropriation bills. These are a continuing resolution (sometimes called a continuing appropriations bill) and an omnibus appropriations bill.

Often when Congress cannot agree on spending levels and appropriations, the legislative body faces the prospect of an imminent funding lapse for the federal government. To act as a stopgap measure, Congress often turns to a continuing resolution (CR) to keep the government funded. CRs provide authority to federal agencies to continue operations for a fixed period of time at a specified funding rate until regular appropriations are passed. A continuing resolution can last anywhere from a few days to an entire fiscal year, and in practice the previous year’s spending is often used as a baseline. While the advantage of such an approach is that the CR is an easy and usually less controversial solution to funding the government, there are a few downsides. Real spending, or government spending after controlling for inflation, can potentially decline when a CR is used in an environment of rising inflation. Furthermore, there are restrictions regarding what can be done to federal programs under a CR. For example, in the normal appropriations process, a new government program may receive funding from another one that has been put on the chopping block. This is often not possible under a CR.

Another way to keep the government operating but with more flexibility than offered by a CR is through an omnibus appropriations bill. An omnibus bill rolls the 12 individual appropriations bills into one single bill, which contains appropriations for all federal departments and agencies. An omnibus contains regular order appropriation bills, and as such this bill reflects all changes to programs and funding specified by the relevant committees. This route has the advantage of lumping all 12 appropriation bills into one big bill and forces lawmakers to adopt a “take it or leave it” mindset rather than allowing them to be more particular when taking 12 separate votes.

Source: Congressional Budget Office and Wells Fargo Securities

To act as a stopgap measure, Congress often turns to a continuing resolution.

An omnibus bill rolls the 12 individual appropriations bills into one single bill.


Should funding lapse before Congress passes and the president signs a funding bill, the result is a partial federal government shutdown. This shutdown would not include positions that the Executive Office of the President of the United States’ Office of Management and Budget deems excepted personnel.

Congress has multiple options when setting the funding rate in a CR, such as the previous fiscal year's budget authority, the amount that would be appropriated if the House or Senate-passed appropriation was enacted, or the current rate or the president's budget request, whichever is lower. For more detail see the CRS report from footnote 4.
There is also a third option that was used at the end of 2014 and is a hybrid approach of these two tools, known as a CROmnibus. A CROmnibus is a mix of a continuing resolution and an omnibus bill, hence the name. A CROmnibus combines some of the finished appropriation bills with a continuing resolution for the appropriation bills that remain unfinished. For example, in the 2014 CROmnibus, all departments and agencies were funded at new levels with the exception of the Department of Homeland Security, which was funded at the prior fiscal year’s level due to a disagreement over then-President Obama’s executive order on immigration.

**Reconciliation: A Powerful Tool in the Congressional Arsenal**

Budget reconciliation is a term that has grown in importance and relevance in recent years. In short, reconciliation is a fast-track procedure to help policymakers make changes to mandatory spending programs and tax policy. As mentioned previously, the annual appropriations process determines discretionary spending. Mandatory spending, however, is set by pre-determined eligibility requirements, such as age or income, and most aspects of the tax code remain the same from year to year. Reconciliation allows Congress to alter these programs on autopilot and provides a tool with which policymakers can “reconcile” current law with the priorities established in the budget resolution.

Reconciliation has gained prominence in these partisan times due to its privileged status; final passage requires a simple majority, and debate time in the Senate is limited, preventing a filibuster by the minority party. Passing legislation through reconciliation requires a 51-vote majority in the Senate, a much easier hurdle to clear than the de facto 60-vote threshold needed to end a filibuster when considering legislation in the more traditional way.

Because of its special rules, the contents of a reconciliation bill are tightly controlled. Several of these restrictions fall under the “Byrd Rule,” which helps govern what is and is not allowed under reconciliation. A provision of a reconciliation bill violates the Byrd Rule if:

- It does not produce a change in outlays or revenue
- The net budgetary effect of a title reported by the reconciled committee is such that the committee does not achieve its fiscal target
- The committee reports a title containing matter outside its jurisdiction
- The budgetary effects of a provision are “merely incidental” to the overall policy objective
- The reported title causes an increase in the deficit in any year outside the budget window
- The provision makes changes to the retirement and disability programs in Title II of the Social Security Act

Broadly speaking, these restrictions are designed to help ensure that Congress utilizes reconciliation for its original budget-related purposed and not simply to take advantage of the special rules governing this type of legislation.

As it pertains to the current fiscal policy debate, the original plan by the Republican majority looked something like this: Pass a FY 2017 budget resolution that would instruct the relevant committees to begin work on the repeal and replacement of the Affordable Care Act (ACA). Then, once complete, Congress would pass a FY 2018 budget resolution that would provide instructions to begin work on changes to the tax code. With the ACA repeal/replace still in limbo, however, the FY 2018 budget resolution remains log jammed. This has created problems that have permeated beyond the tax reform debate because, as outlined earlier, the budget resolution sets the top-line funding levels that appropriators use when divvying up the pie. Without top-line funding numbers, the annual appropriations process for FY 2018 has fallen behind, likely setting up another year of unconventional budgeting (such as a CR or omnibus).

In theory, Republicans could scrap the FY 2017 budget resolution, pass one for FY 2018, and attempt to do tax policy changes and ACA repeal/replace simultaneously. However, they would have to be in the same bill. Given the challenges Republicans have faced on these topics as separate issues, and given the inevitable length and complexity of such a bill, policymakers have resisted this route so far.
How Does the Debt Ceiling Fit In?
The most useful way to think about the debt ceiling is that it represents the authorization to pay the federal government’s credit card bill. The **debt ceiling** is a statutory upper limit on the borrowing authority of the federal government. Congress through regular (or irregular) budget processes has already agreed to provide a certain level of funding for prior years. When spending outpaces revenues, the government makes up the difference through borrowing to meet this level of funding. When the nation bumps up against the debt ceiling, the U.S. Department of the Treasury, to meet the spending needs not met by tax collections, is unable to issue additional debt. Debt ceiling votes have become much more controversial in recent years as more fiscally conservative members of Congress have insisted on tying budget cuts (which would need to take place through the appropriations process) to increases in the nation’s debt ceiling. In other words, some members use the necessary debt ceiling vote as leverage to make cuts to federal spending.

Figure 4
U.S. Debt Ceiling
End of Fiscal Year, Trillions of USD

[Diagram showing U.S. Debt Ceiling from 1997 to 2017]

When Congress puts off lifting the borrowing limit, the U.S. Treasury utilizes a set of **“extraordinary measures”** to keep the nation under the statutory borrowing limit, primarily by halting investments in select government funds. These measures buy time for Congress to enact a debt ceiling increase. There has not been a case where the Treasury’s extraordinary measures have run out and Congress failed to lift the borrowing limit. If at some point the extraordinary measures were exhausted, the U.S. Treasury would have the very difficult task of attempting to prioritize payments based on the realized cash flows received by the Treasury. In theory, if U.S. interest payments were not prioritized, the U.S. would fall into a state of default on its sovereign debt. In 2011, the debt ceiling debate went on nearly to the point of the Treasury’s extraordinary measures running out. Following the lifting of the debt ceiling, one credit rating agency downgraded the credit rating of the U.S. federal government. Later, the Government Accountability Office (GAO) found that the delay in lifting the borrowing limit resulted in an additional $1.3 billion in borrowing costs to the federal government in FY 2011.8

The Process Continues to Evolve
We have boiled down the complex U.S. federal budget process into its constituent parts, but it is worth noting that the process is continuously evolving. In an increasingly partisan environment, lawmakers are turning to new ways to navigate the budget process and, in some cases, changing the rules that traditionally govern the process. We suspect that processes such as reconciliation and the CROmnibus will become some of the more frequently utilized tools to emerge from the current political environment.

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<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
<th>Phone Numbers</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Diane Schumaker-Krieg</td>
<td>Global Head of Research, Economics &amp; Strategy</td>
<td>(704) 410-1801 (212) 214-5070</td>
<td><a href="mailto:diane.schumaker@wellsfargo.com">diane.schumaker@wellsfargo.com</a></td>
</tr>
<tr>
<td>John E. Silvia, Ph.D.</td>
<td>Chief Economist</td>
<td>(704) 410-3275</td>
<td><a href="mailto:john.silvia@wellsfargo.com">john.silvia@wellsfargo.com</a></td>
</tr>
<tr>
<td>Mark Vitner</td>
<td>Senior Economist</td>
<td>(704) 410-3277</td>
<td><a href="mailto:mark.vitner@wellsfargo.com">mark.vitner@wellsfargo.com</a></td>
</tr>
<tr>
<td>Jay H. Bryson, Ph.D.</td>
<td>Global Economist</td>
<td>(704) 410-3274</td>
<td><a href="mailto:jay.bryson@wellsfargo.com">jay.bryson@wellsfargo.com</a></td>
</tr>
<tr>
<td>Sam Bullard</td>
<td>Senior Economist</td>
<td>(704) 410-3280</td>
<td><a href="mailto:sam.bullard@wellsfargo.com">sam.bullard@wellsfargo.com</a></td>
</tr>
<tr>
<td>Nick Bennenbroek</td>
<td>Currency Strategist</td>
<td>(212) 214-5636</td>
<td><a href="mailto:nicholas.bennenbroek@wellsfargo.com">nicholas.bennenbroek@wellsfargo.com</a></td>
</tr>
<tr>
<td>Anika R. Khan</td>
<td>Senior Economist</td>
<td>(212) 214-8543</td>
<td><a href="mailto:anika.khan@wellsfargo.com">anika.khan@wellsfargo.com</a></td>
</tr>
<tr>
<td>Eugenio J. Alemán, Ph.D.</td>
<td>Senior Economist</td>
<td>(704) 410-3273</td>
<td><a href="mailto:eugenio.j.aleman@wellsfargo.com">eugenio.j.aleman@wellsfargo.com</a></td>
</tr>
<tr>
<td>Azhar Iqbal</td>
<td>Econometrician</td>
<td>(704) 410-3270</td>
<td><a href="mailto:azhar.iqbal@wellsfargo.com">azhar.iqbal@wellsfargo.com</a></td>
</tr>
<tr>
<td>Tim Quinlan</td>
<td>Senior Economist</td>
<td>(704) 410-3283</td>
<td><a href="mailto:tim.quinlan@wellsfargo.com">tim.quinlan@wellsfargo.com</a></td>
</tr>
<tr>
<td>Eric Viloria, CFA</td>
<td>Currency Strategist</td>
<td>(212) 214-5637</td>
<td><a href="mailto:eric.viloria@wellsfargo.com">eric.viloria@wellsfargo.com</a></td>
</tr>
<tr>
<td>Sarah House</td>
<td>Economist</td>
<td>(704) 410-3282</td>
<td><a href="mailto:sarah.house@wellsfargo.com">sarah.house@wellsfargo.com</a></td>
</tr>
<tr>
<td>Michael A. Brown</td>
<td>Economist</td>
<td>(704) 410-3278</td>
<td><a href="mailto:michael.a.brown@wellsfargo.com">michael.a.brown@wellsfargo.com</a></td>
</tr>
<tr>
<td>Jamie Feik</td>
<td>Economist</td>
<td>(704) 410-3291</td>
<td><a href="mailto:jamie.feik@wellsfargo.com">jamie.feik@wellsfargo.com</a></td>
</tr>
<tr>
<td>Erik Nelson</td>
<td>Currency Strategist</td>
<td>(212) 214-5652</td>
<td><a href="mailto:erik.f.nelson@wellsfargo.com">erik.f.nelson@wellsfargo.com</a></td>
</tr>
<tr>
<td>Michael Pugliese</td>
<td>Economic Analyst</td>
<td>(704) 410-3156</td>
<td><a href="mailto:michael.d.pugliese@wellsfargo.com">michael.d.pugliese@wellsfargo.com</a></td>
</tr>
<tr>
<td>E. Harry Pershing</td>
<td>Economic Analyst</td>
<td>(704) 410-3034</td>
<td><a href="mailto:e.h.pershing@wellsfargo.com">e.h.pershing@wellsfargo.com</a></td>
</tr>
<tr>
<td>Hank Carmichael</td>
<td>Economic Analyst</td>
<td>(704) 410-3059</td>
<td><a href="mailto:john.h.carmichael@wellsfargo.com">john.h.carmichael@wellsfargo.com</a></td>
</tr>
<tr>
<td>Donna LaFleur</td>
<td>Executive Assistant</td>
<td>(704) 410-3279</td>
<td><a href="mailto:donna.lafleur@wellsfargo.com">donna.lafleur@wellsfargo.com</a></td>
</tr>
<tr>
<td>Dawne Howes</td>
<td>Administrative Assistant</td>
<td>(704) 410-3272</td>
<td><a href="mailto:dawne.howes@wellsfargo.com">dawne.howes@wellsfargo.com</a></td>
</tr>
</tbody>
</table>

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