

Statement of
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Subcommittee on the Constitution
Committee on the Judiciary
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Mr. Chairman, I am pleased to testify today before this Committee on the balanced budget amendment. Concern over the budget imbalance is clearly warranted and one that I share. I also support the objectives of reducing **deficits** and balancing government expenditures and receipts. It is not clear, however, that the problem is one of procedure rather than of substance. I think that it is the latter. However, I can certainly understand why proponents of such an amendment think it is appealing.

ARGUMENTS FOR A BUDGET-LIMITING AMENDMENT

In the nineteenth century, and for the first part of the twentieth, it was generally understood that government budgets should be balanced except under extraordinary circumstances such as those posed by wars. The rule was so widely believed that it disciplined government, and deficits were the exception rather than the rule.

•The **Keynesian** Revolution of the 1930s deprived us of the balanced budget rule. It provided an intellectual **justification** for using variations in budget deficits to influence aggregate demand and employment in the economy. If the new theory had been **precise** enough to prescribe a deficit of a certain size in each year, it, too, could have been a disciplinary force, because at least we would have known that that deficit should not be

exceeded. Unfortunately, the theory was not precise, and the appropriate size for the deficit was something that economists and legislators could argue about at length. In effect, we were left without a disciplinary rule that had general approval.

There have been many attempts to invent alternative rules. For example, it has been argued that the budget should be balanced on average over the business cycle, or that it should be balanced if calculated as though the economy were operating at full employment. But no proposed substitute has ever gained the force of the old-fashioned, **balance-the-budget** rule. As a result, every decade since World War II has seen higher deficits on average.

The desire to amend the Constitution to require a balanced budget rule can be understood as an attempt to reinstate the disciplinary rule that seemed to serve us well prior to the Great Depression. The question is, "Could it be made to work, or would it do more harm than good?"

PROBLEMS OF IMPLEMENTATION

Can the Constitution be used to **force** a solution on the Congress? While there is general agreement that current deficits are much too high

and should be reduced, there is little agreement about what the nation's ultimate goals should be, how fast to approach them, or how best to reach them. Prohibition brought into sharp focus the problems involved in using the Constitution to force a mode of behavior on an unwilling public. The balanced budget amendment might create the same sort of problems, because it can easily be evaded: there are numerous technical problems involved in implementing it, and it invites political stalemate.

Evasion Strategies

Virtually any fixed constraint on public or private activity leads to the development of strategies to avoid controls. Forty-nine states have constitutions designed to balance their budget according to some definition or another. In some states, the process works well. In others, where there has been a conflict between political incentives and the state constitutions, the latter has been evaded by creating independent agencies and through other devices.

In New York State in the 1970s, there was a proliferation of independent agencies, operating spending was redefined to be capital spending, and something called a moral obligation bond was invented to avoid restraints on borrowing. More generally, state balanced budget

amendments did not prevent the rate of growth of state and local spending from far exceeding the federal growth rate between World War II and the mid-1970s.

At the federal level, even without the pressures of a constitutional restraint, there are constant attempts to move government economic intervention outside of the budget process. A constitutional amendment would intensify these pressures; and once an activity is moved outside of the budget, there is a danger that it will grow completely out of government control.

Recent attempts to reduce the current budget deficit, but to continue the government-supported activity, have been made by the Administration, Congressional committees, and by outside interest groups. The Administration, for example, proposed that Export-Import Bank direct loans be converted to government-guaranteed loans with subsidized interest. The actual subsidies conveyed to the subsidized borrowers would remain the same; the costs to the borrowers would increase because the interest cost of guaranteed private loans is higher than the government's borrowing costs; the capital demands on the investment markets would change only to the extent that the sum total of guaranteed and direct loans is reduced; but, as measured by the total budget, government outlays and the deficit would be reduced by \$7.1 billion over the next five years. Similarly, the Administra-

tion's budget proposes to convert the Farmers Home Administration's direct agricultural loans into guaranteed loans. Both policy decisions maintain the government-supported activity but reduce its impact on the total budget deficit.

Various Congressional committees and interest groups have proposed comparable changes to current programs either to avoid budget controls or to allow increased activity for favored programs. Last years' rural electrification bill, S. 1300, would have forgiven \$7.9 billion in debt to the Treasury "to insure the continued financial integrity of the . . . REA." This change would have reduced the REA outlays but left the debt unpaid. New proposals to support industrial development and investment in infrastructure would be financed through government guarantees to private investors rather than through government expenditures. The impact on capital markets of the sale of Treasury notes and government-guaranteed securities is essentially the same, but the budget impact is far different. To avoid the Administration's proposed cuts to the Small Business Administration, some of its supporters are proposing the creation of an off-budget, government-sponsored enterprise to finance small business investment companies.

Regulation can often be a substitute for government's power to tax and spend. For example, President Nixon once suggested implementing a national health insurance system by requiring that employers provide a

specified private insurance plan for their employees. The plan had relatively minor budget consequences but would have been a major drain on the nation's resources. Whatever one thinks of the government's ability to control budget totals, regulatory policies can often be even more difficult to control because their costs are much less apparent.

Technical Implementation Problems

The resolution before the Committee requires that total outlays do not exceed total receipts and restricts the growth of receipts to the growth in national income. The resolution further directs the Congress to enforce the amendment by appropriate legislation.

While the simplicity of this language should minimize problems of interpretation, ambiguities remain. Under current policy, definitions of the concepts of receipts, outlays, and national income are revised periodically to reflect changed budgetary factors. Changes in concepts, such as how to treat tax expenditures, would presumably continue to occur.

One implementation issue that may cause difficulty grows out of the existence of several major federal programs with dedicated tax revenues designed to equal program spending over a period of years, rather than in

each year. The trust funds for Social Security, Medicare, Unemployment Insurance, Airports and Airways, Highways, and so on all build reserves in some years and draw those reserves down in other years. Under the proposed constitutional amendment, when trust fund reserves are drawn down, spending would have to be cut by a like amount elsewhere in the budget--if it is to be in balance--or a supermajority would have to vote an exception for trust fund spending. Once a well-justified exception is made, however, there might be great temptation to make others for which the case is not as strong.

Another serious problem can be anticipated in measuring the control totals. Budget plans and the impact of enacted legislation are currently based on estimated budget effects. Even preliminary data on outlays and receipts are not now available until almost a month after each month's activity. Under the balanced budget amendment, the Congress would either have to base its enforcement actions on estimates or make adjustments after the end of the fiscal year.

The size of the changes required within a short time frame could also present difficulty. Using the budgetary rules of thumb cited in CBO's annual report (The Economic and Budget Outlook: Fiscal Years 1986-1990, February 1985, p. 75), a one percent increase in interest costs would result in a \$9 billion increase in the deficit. A one percent change in unemployment

would require an even larger enforcement action by the Congress. If the imprecision in the estimates were not discovered until six months into a year, a \$9 billion increase in the deficit would require an immediate reduction in spending at an annual rate of \$18 billion.

Possibility of Impasse

The Constitution empowers the Congress to do many things but requires it to do only a few. In no case does the Constitution currently prescribe what **decision** is to be reached. The balanced budget amendment would require the Congress to adopt a balanced budget. The alternative would be for a **supermajority--three-fifths** of the **Members--to** approve an unbalanced budget. There is no provision in the amendment for how to settle the matter if there is neither a majority for a balance nor a supermajority for an imbalance.

The current budget debate in the Senate suggests that such an impasse could easily occur. The budget process now in place is much less demanding than that implied by a constitutional amendment, and yet it is far behind the schedule promulgated in the Budget Act. It is proving difficult to get a majority behind any single budget package. **Imagine** the problems of **obtaining** a supermajority for the **deficits** envisioned by various plans for the

next few years. There is little doubt that each legislator sincerely believes that his or her favorite plan is superior to all others, and the key question is whether the Constitution could be used to force legislators to vote for plans that they deem to be inferior. Individuals are often willing to compromise, and that is what makes the system work. But can they be forced to compromise; and, if not, what next?

NEED FOR A PHASED IMPLEMENTATION

The implementation of a balanced budget amendment or even the reduction in the current deficit must be accomplished over a number of years. A sudden reduction in government spending or increase in taxes would disrupt the economy. If spending were reduced substantially and abruptly, incomes of taxpayers, entitlements to beneficiaries, and goods and services sold by firms to the government would fall, setting off a chain of **declining** purchases, reductions in output, and job cutting. Major tax increases could have similar disruptive effects.

CONCLUSION

Exploding deficits have created much frustration, and it is not surprising that we are diligently searching for procedural solutions to help us

cope with a highly undesirable situation. There is little doubt that constitutional provisions work well if the public is strongly behind them. In the absence of such support, an artificial constraint can cause chaos, as Prohibition clearly showed.

With regard to a balanced budget, the evidence is ambiguous. In some states, balanced budget provisions have worked fairly well, while in the case of New York they worked very badly. They have not, however, greatly curbed the growth of state and local spending over the long run. Public opinion polls suggest an electorate that gives strong generalized support to the concept of a balanced federal budget, but one that is also greatly averse to higher taxes and to most program cuts. Clearly, this makes the implementation of a balanced budget amendment a risky enterprise, because of the temptation and the many opportunities to evade it.

No constitutional provision can be guaranteed to work perfectly. If the public does not strongly support the actions needed to reach a balanced budget, the possibility of an impasse exists, and the evasion techniques that are likely to emerge are particularly inefficient and could significantly damage the economy.