

Preventing America's Looming Fiscal Crisis: The Need for a Balanced Budget Amendment to the Constitution

Testimony to the
Senate Judiciary Committee

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* The opinions expressed herein are mine alone and do not represent the position of the American Action Forum. I thank Gordon Gray for his assistance.

Introduction

Chairman Grassley, Ranking Member Leahy and members of the Committee, I am pleased to have the opportunity to appear today. In this testimony, I wish to make four basic points:

- The federal budget outlook is quite dire, harms economic growth, and ultimately raises the real threat of a sovereign debt crisis,
- The adoption of a "fiscal rule" would be a valuable step toward budgetary practice that would address this threat and preclude its recurrence,
- A balanced budget amendment to the U.S. Constitution is one such fiscal rule; one whose very nature would render it an effective fiscal constraint immune from the forces that have generated a history of Congresses reneging on budgetary targets, and
- Recent incarnations of a balanced budget amendment contain provisions that address some traditional concerns regarding balanced budget requirements.

I will pursue each in additional detail.

The Budgetary Threat

The federal government faces enormous budgetary difficulties, largely due to long-term pension, health, and other spending promises coupled with recent programmatic expansions. The core, long-term issue has been outlined in successive versions of the Congressional Budget Office's (CBO's) *Long-Term Budget Outlook*¹. In broad terms, the inexorable dynamics of current law will raise federal outlays from an historic norm of about 20 percent of Gross Domestic Product (GDP) to anywhere from 30 to nearly 40 percent of GDP. Spending at this level will far outstrip revenue, even with receipts projected to exceed historic norms, and generate an unmanageable federal debt spiral.

This depiction of the federal budgetary future and its diagnosis and prescription has all remained unchanged for at least a decade. Despite this, meaningful action (in the right direction) has yet to be seen, as the most recent budgetary projections demonstrate.

In January, the Congressional Budget Office released its updated budget and economic baseline for 2016-2026. The basic picture from CBO is as follows: tax revenues return to pre-recession norms, while spending progressively grows over and above currently elevated numbers. The net effect is an upward debt trajectory on top of an already large debt portfolio. The CBO succinctly articulates the risk this poses: "Such high and rising debt would have serious negative consequences for the budget and the nation... Such high and

¹ Congressional Budget Office. 2015. *The Long-Term Budget Outlook*. Pub. No. 50250. <https://www.cbo.gov/publication/50250>

rising debt relative to the size of the economy would dampen economic growth and thus reduce people’s incomes compared with what otherwise would be the case. It would also increasingly restrict policymakers’ ability to use tax and spending policies to respond to unexpected challenges, and it would boost the risk of a fiscal crisis in which the government would lose its ability to borrow at affordable rates.”²

Figure 1: The Budget Outlook by the Numbers

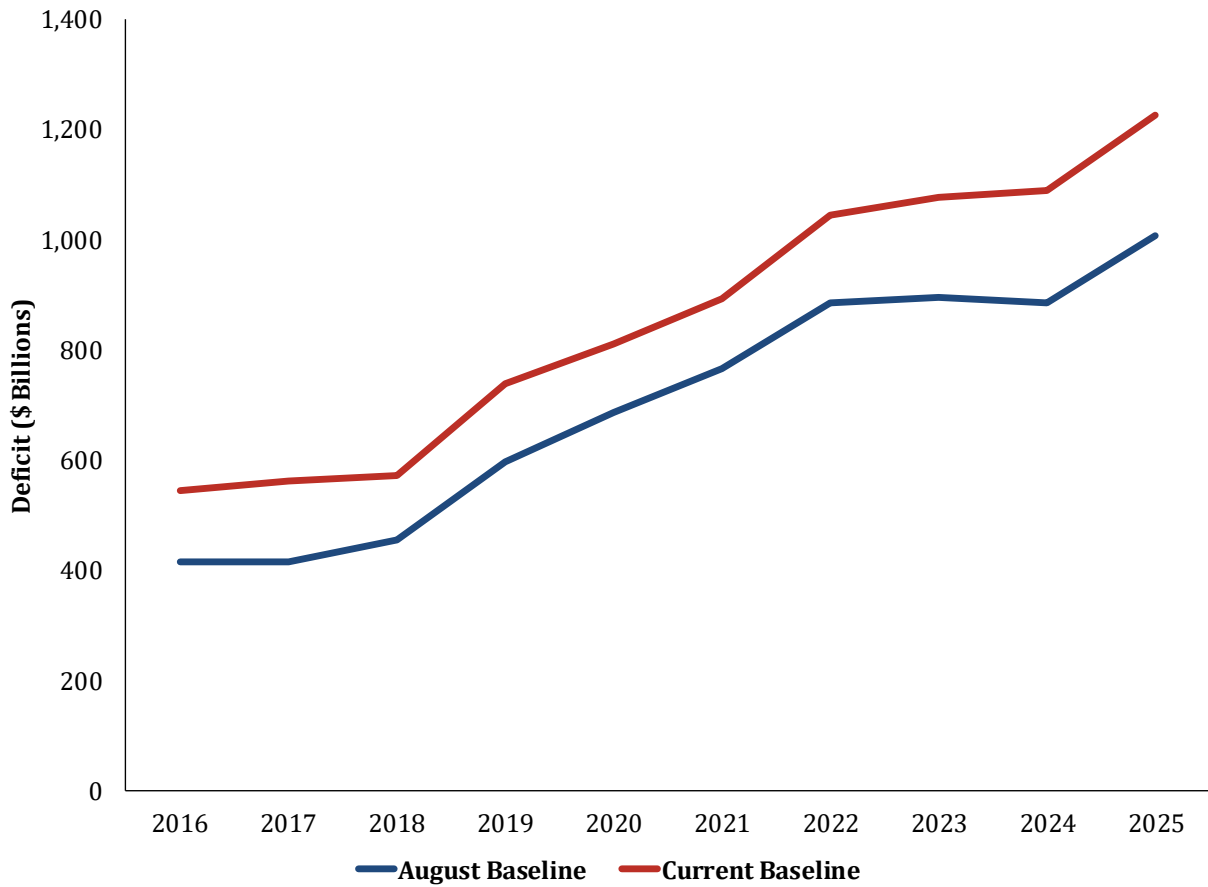
	Unit	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2017-2021	2017-2026
Revenues	\$ Billions	1,739	1,827	1,902	1,987	2,084	2,184	2,292	2,406	2,529	2,657	9,539	21,608
	% of GDP	18.2	18.1	17.9	18.0	18.0	18.0	18.0	18.1	18.1	18.2	18.0	18.1
Outlays	\$ Billions	4,072	4,206	4,485	4,727	4,968	5,288	5,498	5,699	6,044	6,401	22,458	51,388
	% of GDP	21.1	20.9	21.5	21.8	22.0	22.5	22.4	22.3	22.8	23.1	21.5	22.1
Deficit	\$ Billions	-561	-572	-738	-810	-893	-1,044	-1,077	-1,089	-1,226	-1,366	-3,575	-9,378
	% of GDP	-2.9	-2.8	-3.5	-3.7	-4.0	-4.4	-4.4	-4.3	-4.6	-4.9	-3.4	-4.0
Debt Held by the Public	\$ Billions	19,297	20,127	20,906	21,710	22,593	23,528	24,497	25,506	26,559	27,660	104,632	232,382
	% of GDP	75.7	75.7	76.7	77.8	78.8	80.3	81.7	82.8	84.3	86.1	n.a.	n.a.

According to the CBO, tax revenue will remain above 18 percent of GDP over the next ten years. This is well above the 40-year average of 17.4 percent. The federal government is projected to spend over \$51 trillion over ten years, maintaining spending levels 1.6 percentage points above historical levels. Mandatory spending, which comprised 46 percent of the federal budget in 1976, will reach 65 percent in 2026. Interest payments on the debt comprised 7 percent of the budget in 1976 and 6 percent in 2015. These payments will more than double to 13 percent of the budget. Debt service payments will reach 3 percent of GDP by 2026 – well in excess of the 40-year average of 2.1 percent.

Over 2017-2026, projected deficits will surpass \$1 trillion again by 2022. Importantly, the deficit outlook has worsened since CBO’s last estimate by over \$1.5 trillion. While about \$750 billion of this projected increase is attributable to legislation, the balance of this more pessimistic projection is due to weaker projected growth and technical assumptions.

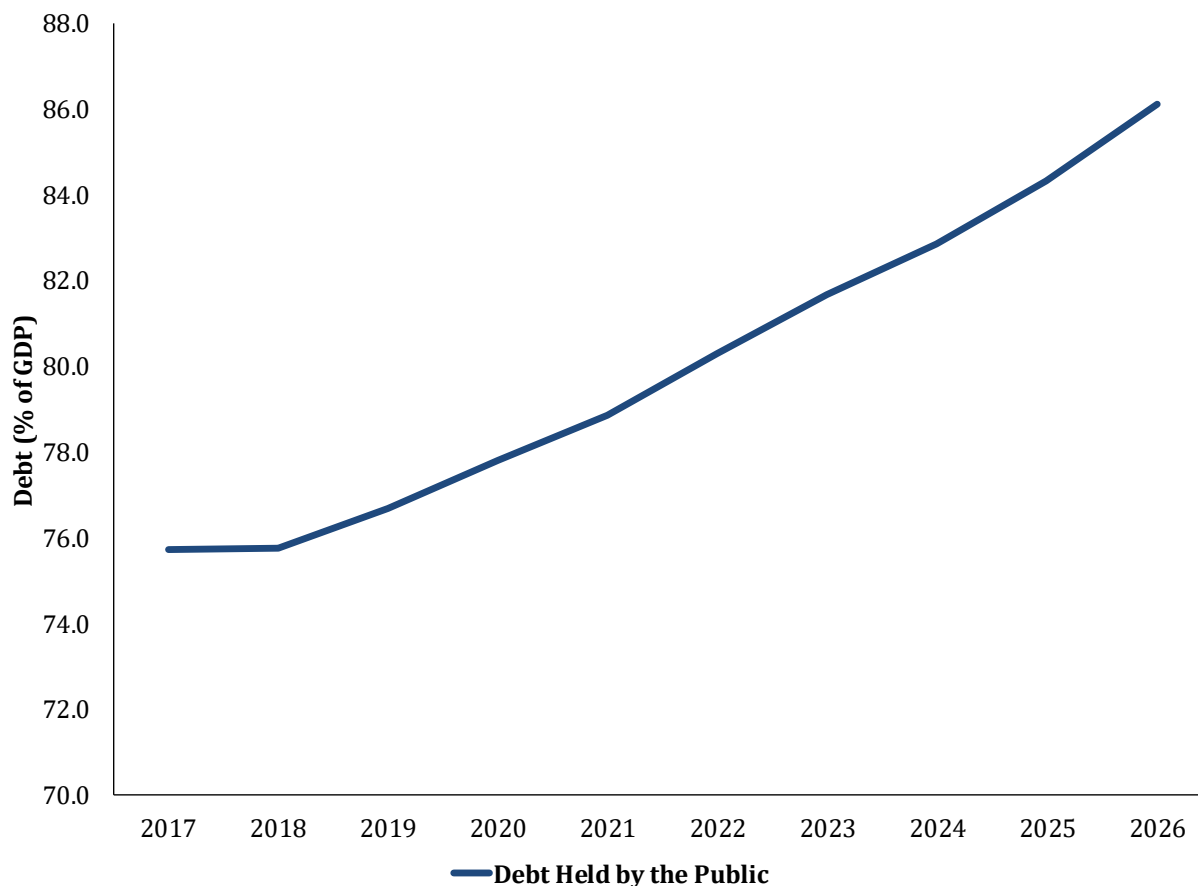
² Congressional Budget Office. 2016. *The Budget and Economic Outlook: 2016 to 2026*. Pub. No. 51129. <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51129-2016Outlook.pdf>

Figure 2: The Deficit Outlook has Worsened



The worsened deficit outlook will raise borrowing from the public over the coming decade. Debt held by the public will reach the highest levels since 1950 in FY 2016, reaching 75.7 percent of the economy, while projected to grow to levels not seen since 1947 by the end of the decade.

Figure 3: Debt Ultimately on an Upward Trajectory



The trajectory, direction and the magnitude of the current debt outstanding is ultimately the most telling characteristic of the U.S. fiscal path. The widely acknowledged drivers of the long-term debt, health, and retirement programs for aging populations, and borrowing costs, will begin to overtake higher than average tax revenue and steady economic growth by the middle of the decade, and grow ever inexorably upwards until creditors effectively refuse to continue to finance our deficits by charging ever higher interest payments on an increasingly large debt portfolio. This crisis state is more pernicious than mere stabilization of the debt at a high level, which would suppress economic growth as financing the debt crowds out other productive investment. Rather, unchecked accumulation of debt would precipitate a fiscal crisis that would upend world financial markets and do lasting harm to the nation’s standard of living. The growing risk that the United States could face such a fiscal crisis requires the serious consideration of a fiscal rule, namely a balanced budget amendment, to forestall the deleterious economic consequences that attend to sovereign debt crises.³

³ For more on the specific ramifications of a potential U.S. fiscal crisis, see: <http://financialservices.house.gov/uploadedfiles/hhrg-113-ba00-wstate-dholtzeakin-20140325.pdf>

The Value of Fiscal Rules

At present, the federal government does not have a fiscal "policy." Instead, it has fiscal "outcomes". The House and Senate do not always agree on a budget resolution. Annual appropriations reflect the contemporaneous politics of conference committee compromise, and White House negotiation. Often, the annual appropriations process is, in whole or in part, replaced with a continuing resolution. Annual discretionary spending is not coordinated in any way with the outlays from mandatory spending programs operating on autopilot. And nothing annually constrains overall spending to have *any* relationship to the fees and tax receipts flowing into the U.S. Treasury. The fiscal outcome is whatever it turns out to be - usually bad - and certainly not a policy choice.

I believe that it would be tremendously valuable for the federal government to adopt a fiscal rule. Such a rule could take the form of an overall cap on federal spending (perhaps as a share of GDP), a limit on the ratio of federal debt in the hands of the public relative to GDP, a balanced budget requirement, or many others. Committing to a fiscal rule would force the current, disjointed appropriations, mandatory spending, and tax decisions to fit coherently within the adopted fiscal rule. Accordingly, it would force lawmakers to make tough tradeoffs, especially across categories of spending.

Most importantly, it would give Congress a way to say "no." Spending proposals would not simply have to be good ideas. They would have to be *good enough* to merit cutting other spending programs or using taxes to dragoon resources from the private sector. Congress would more easily be able to say, "not good enough, sorry."

What should one look for in picking a fiscal rule? First, it should work; that is, it should help solve the problem of a threatening debt. A fiscal rule like PAYGO at best stops further deterioration of the fiscal outlook and does not help to solve the problem.

Second, it is important that there be a direct link between policymaker actions and the fiscal rule outcome.

Finally, the fiscal rule should be transparent so that the public and policymakers alike have a clear understanding of how it works. This is a strike against a rule like the ratio of debt-to-GDP. The public has only the weakest grip on the concept of federal debt in the hands of the public, certainly does not understand how GDP is produced and measured, and (God help us) may not be able to divide. Without transparency and understanding, public support for the fiscal rule will be too weak for it to survive.

As documented by the Pew-Peterson Commission on Budget Reform other countries have benefitted from adopting fiscal rules.⁴ The Dutch government established separate caps on expenditures for health care, social security and the labor market. There are also sub-caps within the core sectors.

⁴ <http://www.budgetreform.org/>

Sweden reacted to a recession and fiscal crisis by adopting an expenditure ceiling and a target for the overall government surplus (averaged over the business cycle). Later (in 2000) a balanced budget requirement was introduced for local governments. Finally, in 2003 the public supported a constitutional amendment to limit annual federal government spending to avoid perennial deficits.

A lesson is that, no matter which rule is adopted, it will rise or fall based on political will to use it and the public's support for its consequences.

A Balanced Budget Amendment

How should one think of proposals to amend the Constitution of the United States to require a balanced federal budget? It would clearly be quite significant. Despite the good intentions of the Budget Control Act of 2011, there is little indication that the resultant savings will do anything but delay the fiscal threats outlined above. Absent significant fiscal reform, these challenges will continue to evolve from pressing to irreversible. The distinguishing characteristics of a Constitutional amendment to address these challenges make it a far more robust tool in this endeavor.

First, fiscal constraints, in the form of spending caps, triggers, and other like devices are laudable, but fall short of Constitutional amendment in their efficacy as a fiscal rule similar to those pursued by nations such as the Netherlands and Sweden. A Constitutional amendment, by design, is (effectively) permanent, and therefore persistent, even if bypassed in certain exigent circumstances, in its effect on U.S. fiscal policy. Fiscal rules should allow policy figures to say "no." A Constitutional amendment will not only allow that, but given the gravity inherent in a Constitutional amendment, hopefully dissuade contemplation of legislative end-arounds that other rule might invite.

Second, there is a clear link between Congressional actions - cutting spending, raising taxes - and the adherence to a balanced budget amendment. Of course, Congressional action is not all that determines annual expenditures and receipts.

Military conflicts and other such contingencies can incur costs without advance Congressional action, while economic conditions can affect spending, such as with unemployment insurance and other assistance programs, and tax revenues. However, these fluctuations are ultimately not the driving force between the U.S. fiscal imbalance. Indeed, in a world with stable tax revenue and without the need for military contingencies, the U.S. would still be headed towards fiscal crisis. Rather, enacted spending and tax policy largely set forth the U.S. fiscal path that must be altered to avert a fiscal crisis. A meaningful constraint on these factors would confront policymakers with the necessity to alter those policies, and as discussed above, to make the choices and tradeoffs needed to shore up the nation's finances. Tying those choices to an immutable standard, in the form of a Constitutional amendment, would facilitate that process.

A third facet of a Constitutional amendment that augurs well for its efficacy is the ratification process itself. This is a process that takes years. Successful ratification of a Constitutional amendment requires acceptance at many levels of public engagement. For the purpose of constraining federal finances, this is beneficial, as it necessarily requires public "buy-in." Without question, the changes needed to address federal spending policy will be difficult. Any process that engages the public, and by necessity, requires public complicity to be successful will ease the process of enacting otherwise difficult fiscal changes.

Lastly, the very nature of a Constitutional amendment shields it from the annual, or perhaps more frequent, vicissitudes of federal policymaking. It cannot be revised, modified, or otherwise ignored in the fashion of the many checks on fiscal policy enacted or attributable to the Congressional Budget Act of 1974 or its successors.

Congress cannot renege on its obligations with such an amendment in place. While unquestionably a constraint on Congress, as a parameter of federal policymaking it would be one by which all must abide.

Auxiliary Features of a Balanced Budget Proposal

As noted above, a balanced budget amendment to the Constitution has several unique characteristics that distinguish it as an effective fiscal rule. However, not all balanced budget amendments are created equal. Balanced budget amendments can differ significantly, with considerable variation in the consequence of their design.

While largely the result of choices by policymakers, the U.S. fiscal situation is, and will be in the future, shaped in some way by forces outside of the legislative process, such as war, calamity, or economic distress. Critical to an effective balanced budget amendment is the acknowledgment of this reality with a mechanism for adjusting to these forces without undermining the goal of the amendment to constrain fiscal policy. The abuse of emergency designations in legislation to get around budget enforcement is an example of what can happen when the goal of constraining fiscal policy is subordinated to flexibility in the face of some crisis, real or otherwise. Stringent accountability, such as the requirement of supermajority, affirmative votes can mitigate this problem.

Past iterations of balanced budget amendments have legitimately raised questions as to their capacity to limit the scale of the federal government. There is nothing inherent in a balanced budget amendment to limit federal spending beyond the belief that at some point, the tax burden necessary to balance the expenditure of a large federal government ultimately reaches an intolerable level. But there is nothing about a balanced budget amendment alone that precludes reaching tax and spending levels just approaching that tipping point, which is far from desirable policy. Accordingly, recent examples of balanced budget amendments seek to staunch the accumulation of debt, which is ensured by balance, while also limiting the spending to the historical revenue norm. Likewise, recent examples of balanced budget amendments that limit the Congress's ability to raise taxes. In

each case these limitations can be waived by supermajority votes. These are sound approaches that address concerns that a requirement to be in balance will add tax policy to the share of fiscal policy already on autopilot.

The last issue of concern, but with a less obvious remedy relates to enforcement. It is not obvious in any of the extant amendments what would occur if the requirements of the amendment were violated. The enforcement mechanism for these requirements arguably may not exist, and may not exist until tested after the ratification of a balanced budget amendment. The various waivers provide Congressional allowances for specific overages as a means of establishing compliance should U.S. finances fail to balance or exceed certain limits assuming one of the proposed amendments is successfully ratified. The provision in the prevailing Senate balanced budget amendment prohibiting courts from raising revenues in the event of a "breach" entertains the possibility that the U.S. may indeed find itself in an *ex post* violation of a balanced budget amendment. That suggests that irrespective of the waiver provisions, there is nothing within the amendment itself that addresses enforcement, whether by sequestration or some other means. While many criticisms of past approaches to balanced budget amendments have been meaningfully addressed in recent efforts, the question of enforcement remains a challenge that should be thoughtfully considered.

Thank you for the opportunity to appear today. I look forward to answering any questions the Committee may have.