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CBPP STATEMENT

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STATEMENT BY ROBERT GREENSTEIN ON SENATE REPUBLICAN LEADERS' PROPOSED BALANCED BUDGET AMENDMENT

The balanced budget amendment to the Constitution that Senate Republican leaders unveiled today is the most radical major fiscal policy proposal in decades. It would require a balanced budget every year regardless of the state of the economy, an exceedingly unwise requirement that most economists have long counseled against because it would require the largest budget cuts or tax increases when the economy is weakest and thereby could tip faltering economies into recessions and make recessions worse (see box, p. 3). It also would require budget cuts of such a magnitude as to force policymakers to severely slash Medicare, Medicaid, and many other programs or scrap them altogether — even while opening the door to massive new tax cuts.

Draconian Spending Cuts

The amendment would bar total federal spending from exceeding about 16.7 percent of Gross Domestic Product. It says spending in any fiscal year may not exceed 18 percent of the GDP *of the previous calendar year* (i.e., the calendar year that ended before the fiscal year began). Using CBO's economic assumptions, in the first five years that the amendment would be in effect, the amount of spending allowed would average 16.7 percent of the current year's GDP.

The last year that federal spending was 16.7 percent of GDP or lower was 1956. In that year, Medicare and Medicaid did not exist and millions of workers (including many low-income and minority workers) were excluded from Social Security. Federal aid to education barely existed. Most federal environmental protection did not exist. Nor, for that matter, did most basic programs to ease poverty and hardship such as Supplemental Security Income for the elderly and disabled poor, food stamps, and the Earned Income Tax Credit. More than a third of elderly Americans lived in poverty, infant mortality was far above today's levels, and rates of child malnutrition in some areas of the country approached those of Third World nations.

Even under President Reagan, federal expenditures averaged *22 percent* of GDP — and that was before any members of the baby boom generation had retired; at a time when health care spending was a third lower as a share of GDP than it is today; and before the 9/11 terrorist attacks led policymakers to create a new category of homeland security spending and the wars in Iraq and Afghanistan led to increases in veterans' health costs that will endure for decades.

More Tax Cutting

Since federal spending would fall to 16.7 percent of GDP, the amendment would create room for very big new tax cuts. That's because, with a balanced budget mandate, revenues could be reduced to that level as well. Most Senate sponsors of the amendment favor making permanent *all* of President Bush's tax cuts of 2001 and 2003, including those for the wealthiest Americans. Those tax cuts give people with incomes of more than $1 million tax reductions that average more than *$125,000 a year,* according to the Urban-Brookings Tax Policy Center. Making those tax cuts permanent could be just the start; there would be room for large new tax cuts on top of those. Some policymakers surely would propose further large tax cuts for affluent Americans and large corporations.

Moreover, new tax loopholes — including loopholes that Congress didn't intend but that high-priced tax lawyers and accountants have found ways to create — would become untouchable once they appeared. That's because the amendment would require a *two-thirds vote* of both the House and Senate to raise taxes. Not only would this essentially rule out any revenue contribution to deficit reduction, it also would mean that once a tax loophole opened up, it would become virtually impossible to close (because lobbyists generally could prevent a two-thirds vote in both chambers).

Adding to these problems, the amendment would *heighten the risk of a federal government default* for the first time in U.S. history. It would require a three-fifths vote of both the House and the Senate to raise the debt limit. In recent years, Congress has found it increasingly difficult to secure the votes needed to raise the debt limit, which currently requires only a majority vote in the House (and a majority in the Senate in the absence of a filibuster).

Mistaken Analogies to States and Families

Proponents of the amendment likely will argue that states and families must balance their budgets every year and the federal government should do so, too. But claims that the amendment would align federal budgeting practices with those of states and families would be false.

- States must balance their *operating* budgets, but they can borrow to finance their *capital* budgets — to finance roads, schools, and other projects — and most states do so. States also can build reserves during good times and draw on them in bad times *without* counting the drawdown from reserves as new spending that unbalances a budget.

- Families follow similar practices. They borrow (e.g., mortgages to buy a home or student loans to send a child to college), and they draw down savings when times are tight.

- The amendment, however, would bar such practices at the federal level. The *total* federal budget — including capital investments — would have to be balanced every year, with no borrowing allowed for infrastructure or other investments that can boost future economic growth. And if the federal government ran a surplus one year, it could not draw it down the next year to help balance the budget.

The amendment would pose many risks to the economy. If another financial crisis hit, such as the savings and loan crisis of the late 1980s or the financial market crisis of 2008 and 2009, the federal government would be stuck. It could not mount the critical rescues that it did in those circumstances unless two-thirds of the House and the Senate approved.

In short, this proposed balanced budget amendment to the Constitution risks doing serious damage to the economy, to the nation's basic social fabric, and to the well being of most Americans. It would take us much farther from fiscal and economic sanity, not closer to it.

Economists Warn That Constitutional Balanced Budget Amendment Could Cause Serious Damage to Economy

In testimony before the House Budget Committee in 1992, Robert Reischauer — then director of the Congressional Budget Office and one of the nation's most respected experts on fiscal policy — warned: "[I]f it worked [a balanced budget amendment] would undermine the stabilizing role of the federal government." Reischauer noted that the automatic stabilizing that occurs when the economy is weak "temporarily lowers revenues and increases spending on unemployment insurance and welfare programs. This automatic stabilizing occurs quickly and is self-limiting — it goes away as the economy revives — but it temporarily increases the deficit. It is an important factor that dampens the amplitude of our economic cycles." Under the constitutional amendment, he explained, these stabilizers would no longer operate automatically.[a]

Five years later, when a constitutional balanced budget amendment was under consideration in 1997, more than 1,000 economists, including 11 Nobel laureates, issued a joint statement that said, "We condemn the proposed 'balanced-budget' amendment to the federal Constitution. It is unsound and unnecessary. . . . The proposed amendment mandates perverse actions in the face of recessions. In economic downturns, tax revenues fall and some outlays, such as unemployment benefits, rise. These so-called 'built-in stabilizers' limit declines of after-tax income and purchasing power. To keep the budget balanced every year would aggravate recessions."[b]

This January, the current CBO director, Douglas Elmendorf, sounded a similar warning when asked about a constitutional balanced budget amendment at a Senate Budget Committee hearing. Elmendorf replied:

> Amending the Constitution to require this sort of balance raises risks .... the fact that taxes fall when the economy weakens and spending and benefit programs increase when the economy weakens, in an automatic way, under existing law, is an important stabilizing force for the aggregate economy. The fact that state governments need to work ... against these effects in their own budgets — need to take action to raise taxes or cut spending in recessions — undoes the automatic stabilizers, essentially, at the state level. Taking those away at the federal level risks making the economy less stable, risks exacerbating the swings in business cycles.[c]

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[a] Statement of Robert D. Reischauer before the House Budget Committee, May 6, 1992.

[b] This statement was issued on January, 30, 1997.

[c] Federal Service, Transcript of Senate Budget Committee hearing, January 27, 2011.

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