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Testimony of Robert Greenstein
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Thank you for the invitation to testify today. I am Robert Greenstein, president of the Center on Budget and Policy Priorities, a policy institute that focuses both on fiscal policy and on policies affecting low- and moderate-income Americans. We, like most others who analyze fiscal policy developments and trends, believe that the nation's fiscal policy is on an unsustainable course. As part of our work, we have been analyzing proposed changes in budget procedures for more than 20 years. We have conducted extensive analyses of proposals to write a balanced-budget requirement into the Constitution, among other proposals.

The purpose of changing our fiscal policy course is to strengthen our economy over the long term and to prevent the serious economic damage that would likely occur if the debt explodes in future decades as a share of the economy. But we need to choose our fiscal policy instruments carefully. We want to avoid "destroying the village in order to save it."

The goal of a constitutional balanced budget amendment is to address our long-term fiscal imbalance. Unfortunately, a constitutional balanced budget amendment would be a highly ill-advised way to try to do that and likely would cause serious economic damage. It would require a balanced budget every year regardless of the state of the economy, unless a supermajority of both houses overrode that requirement. This is an unwise stricture that many mainstream economists have long counseled against, because it would require the largest budget cuts or tax increases precisely when the economy is weakest. It holds substantial risk of tipping faltering economies into recessions and making recessions longer and deeper. The additional job losses would likely be very large.

When the economy weakens, revenue growth drops and revenues may even contract. And as unemployment rises, expenditures for programs like unemployment insurance — and to a lesser degree, food stamps and Medicaid — increase. These revenue declines and expenditure increases are temporary; they largely disappear as the economy recovers. But they are critical for helping struggling economies to keep from falling into a recession and for moderating the depth and length of recessions that do occur.

When the economy weakens, consumers and businesses spend less, which in turn causes further job loss. The drop in tax collections and increases in unemployment and other benefits that occur automatically when the economy weakens cushions the blow, by keeping purchases of goods and services from falling more. That is why economists use the term "automatic stabilizers" to describe the automatic declines in revenues and automatic increases in UI and other benefits that occur when the economy turns down; these actions help to stabilize the economy.

A constitutional balanced budget amendment, however, effectively suspends the automatic stabilizers. It requires that federal expenditures be cut or taxes increased to offset the effects of the automatic stabilizers and prevent a deficit from occurring — the opposite course from what sound economic policy calls for.

Over the years, leading economists have warned of the adverse effects of a constitutional balanced budget amendment. For example, in Congressional testimony in 1992, Robert Reischauer — then director of the Congressional Budget Office and one of the nation's most respected experts on fiscal policy — explained: "[I]f it worked [a constitutional 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.[1]

Similarly, 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."[2]

More recently, in January 2011, 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 observed:

> "Amending the Constitution to require this sort of balance raises risks .… [t]he 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."[3]

Proponents of a constitutional amendment likely will respond to these admonitions by noting that the proposed constitutional amendment would allow the balanced-budget requirement to be waived

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

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

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

by a vote of three-fifths of the House and the Senate. That, however, does not address this problem. It is difficult to secure three-fifths votes for anything; consider the paralysis that marks the work of the Senate. Moreover, it may take months after a downturn begins before sufficient data are available to convince three-fifths of the members of both houses of Congress that a recession is underway. Furthermore, it is all too likely that even after the evidence for a downturn is clear, a minority in the House or Senate would hold a wavier vote hostage to demands for concessions on other matters (such as new, permanent tax cuts). By the time a recession were recognized to be underway and three-fifths votes were secured in both chambers, if such support could be obtained at all, extensive economic damage could have been done and hundreds of thousands or millions of additional jobs unnecessarily lost.

The bottom line is that the automatic stabilizers need to continue to be able to work automatically to protect American businesses and workers. The balanced budget amendment precludes that.

Nor is a recession the only concern. Consider the savings and loan crisis of the 1980s, or the financial meltdown of the fall of 2008. A constitutional balanced budget amendment would have hindered swift federal action to rescue the savings and loan industry or to rapidly put the Troubled Assets Relief Program in place. In both cases, history indicates that federal action helped save the economy from what otherwise likely would have been far more dire problems.

Moreover, the federal government provides deposit insurance for accounts of up to $250,000; this insurance — and the confidence it engenders among depositors — is critical to the sound functioning of our financial system so that we avoid panics involving a run on financial institutions, as occurred in the early 1930s. A constitutional prohibition of any deficit spending (unless and until a supermajority of both houses of Congress voted to authorize it) could seriously weaken the guarantee that federal deposit insurance provides. That is a risk we should not take.

These are illustrations of why fiscal policy should not be written into the Constitution.

A parallel problem is that the proposed constitutional amendment would make it even harder than it already is to raise the debt limit, by requiring a three-fifths vote of both the House and Senate to raise the limit. This is playing with fire. It would heighten the risk of a federal government default. A default would raise our interest costs and could damage the U.S. economy for years to come.

Mistaken Analogies to States and Families

Proponents of a constitutional amendment sometimes argue that states and families must balance their budgets every year and the federal government should do so, too. But statements that the constitutional amendment would align federal budgeting practices with those of states and families are not accurate.

While states must balance their *operating* budgets, they can borrow to finance their *capital* budgets — to finance roads, schools, and other projects. 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 — they take out mortgages to buy a home or student loans to send a child to college. They also draw down savings when times are tight, with the result that their expenditures in those periods exceed their current incomes.

But the proposed constitutional amendment 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.

I would also note that the fact that states must balance their operating budgets even in recessions makes it all the more important from the standpoint of economic policy that the federal government *not* be subject to the same stricture. American Enterprise Institute analyst Norman Ornstein addressed this matter in a recent article, where he wrote: "Few ideas are more seductive on the surface and more destructive in reality than a balanced budget amendment. Here is why: Nearly all our states have balanced budget requirements. That means when the economy slows, states are forced to raise taxes or slash spending at just the wrong time, providing a fiscal drag when what is needed is countercyclical policy to stimulate the economy. In fact, the fiscal drag from the states in 2009-2010 was barely countered by the federal stimulus plan. That meant the federal stimulus provided was nowhere near what was needed but far better than doing nothing. Now imagine that scenario with a federal drag instead."[4]

H.J. Res. 1 Raises Additional Issues

The foregoing concerns apply to all versions of the balanced budget amendment that have been introduced. Some versions of the balanced budget amendment, such as H.J. Res 1, raise additional serious concerns, because they would write into the Constitution new prohibitions against raising any revenues — including closing wasteful tax loopholes — to help balance the budget and also would prohibit federal expenditures in any year from exceeding a figure such as 20 percent of the Gross Domestic Product. These constitutional prohibitions could be overridden only by supermajority votes in both the House and the Senate.

This requirement for a supermajority to raise taxes would be extremely unsound. It would protect what President Reagan's former chief economic advisor, Harvard economist Martin Feldstein, has called the biggest area of wasteful government spending in the federal budget — what economists call "tax expenditures" and Alan Greenspan has called "tax entitlements."

In 2010, tax expenditures amounted to $1.1 trillion, more than the cost of Medicare and Medicaid combined (which was $719 billion), Social Security ($701 billion), defense ($689 billion, including expenditures in Iraq and Afghanistan), or non-defense discretionary spending ($658 billion, including expenditures from the Recovery Act). Many of these tax expenditures are fully the equivalent of government spending. Let me use child care as an example.

If you are low- or moderate-income, you may get a federal subsidy to help cover your child care costs, and the subsidy is provided through a spending program. If you are higher on the income

[4] Norman Ornstein, "Four Really Dumb Ideas That Should Be Avoided," *Roll Call*, January 26, 2011.

scale, you still get a government subsidy that reduces your child care costs, but it is delivered through the tax code, as a tax credit. (Moreover, if you are a low or modest income parent with child care costs, you likely will miss out because the spending programs that provide child care subsidies are *not* open ended and can only serve as many people as their capped funding allows. By contrast, if you are a higher income household — and there is no limit on how high your income can be — your child care subsidy is *guaranteed*, because the tax subsidy you get operates as an open-ended entitlement.) It is difficult to justify making the tax-code subsidy sacrosanct and the program subsidy a deficit-reduction target merely because one is delivered through a "spending" program and the other is delivered through the code.

And as the child care example illustrates, sharply distinguishing between subsidies delivered through the tax code and those delivered through programs on the spending side of the budget also has a "reverse Robin Hood" aspect. Low- and moderate-income households receive most of their government assistance through spending programs; affluent households receive most of their federal subsidies through tax expenditures. Effectively barring reductions in tax expenditures from contributing to deficit reduction is a prescription for placing the greatest burden of deficit reduction on those who can least afford to bear it.

The problems do not stop there. If it requires a supermajority to raise any revenue, another likely outcome is a proliferation of tax loopholes. New loopholes — including loopholes that Congress *did not* intend but that high-priced tax lawyers and accountants have found ways to create — could become untouchable once they appeared, because it would require a supermajority of the House and Senate to raise any revenue. It would become more difficult to close tax loopholes that opened up, since special-interest lobbyists could seek to block such action by preventing a supermajority in one chamber.

Finally, H.J. Res 1 would bar federal spending from exceeding 20 percent of GDP. To hit that level would require cuts of a draconian nature. This can be seen by examining the austere budget that the House of Representatives passed on April 15, sometimes referred to as the Ryan budget.

Under that budget, Medicare would be converted to a voucher system under which, the Congressional Budget Office has said, beneficiaries' out-of-pocket health-care costs would nearly triple by 2030 (relative to what those costs would be that year under the current Medicare program). CBO also has written that under the Ryan budget, federal Medicaid funding in 2030 would be 49 percent lower than it would be if the Affordable Care Act's Medicaid expansion were repealed but Medicaid otherwise was unchanged. And funding for non-security discretionary programs would be cut more than one-third below its real 2010 level. Yet CBO says that under this budget, total federal spending would be *20¾ percent of GDP in 2030*, so it would breach the allowable limit under H.J. Res 1. This illustrates the draconian nature of the proposed 20 percent-of-GDP requirement.

Another way to look at the 20 percent of GDP level is to examine federal expenditures under Ronald Reagan. Under President Reagan, who secured deep budget cuts at the start of his term, federal expenditures averaged 22 percent of GDP. And that was at a time *before* any members of the baby boom generation had retired and when health care expenditures throughout the U.S. health care system (including the private sector) were one-third lower as a share of GDP than they are today. It also was before the September 11 terrorist attacks led policymakers to create a new category of homeland security spending, and before the wars in Iraq and Afghanistan led to increases in veterans' health-care costs that will endure for a number of decades.

Conclusion

Policymakers need to begin to change our fiscal trajectory. As various recent commissions have indicated, we need to stabilize the debt as a share of GDP in the coming decade, and to keep it stable after that (allowing for some fluctuation over the business cycle). But establishing a balanced budget amendment in the Constitution would be most unwise. It would likely exact a heavy toll on the economy and on American businesses and workers in the years and decades ahead. It is not the course the nation should follow.