Statement of Alice M. Rivlin
Director, Congressional Budget Office

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Mr. Chairman, I welcome this opportunity to comment on proposals for amending the Constitution to require balance in the federal budget or to restrict the level of federal spending. I do not question the legitimacy of these objectives--the federal budget has been in deficit far too frequently in recent years and strong arguments can be made for lower levels of federal expenditures. But I believe it would be a mistake to attempt to reach these objectives by writing a formula into the Constitution.

- The Congressional Budget Act of 1974 gives the Congress a workable procedure for debating and deciding the overall level of federal spending and the magnitude of the deficit or surplus. Using this procedure to formulate and execute a multiyear budget plan--as the Congress has done this year--holds more promise for balancing the budget and reducing federal spending intelligently than does an inflexible constitutional formula.

- Although a balanced or surplus budget is often an appropriate policy, requiring balance <u>every</u> year would deprive the government of a useful tool for reducing the length and severity of recessions and would shift the full burden of stabilizing the economy onto the Federal Reserve Board.

- A constitutional spending limit or balanced budget requirement would provide incentives for carrying out national objectives through creation of off-budget agencies, allocation of credit, and increased federal regulation. Such developments would probably reduce, rather than enhance, the ability of the public and its elected representatives to monitor and control the activities of the federal government.

Cause for Concern

The relative size of the federal sector has grown substantially over the last 30 years as a result of increased benefit payments to individuals (especially Social Security, food stamps, medical payments, public assistance, student aid, and housing subsidies) along with rising federal grants to finance a wide variety of state and local government services. Federal outlays rose from an average of 18.2 percent of Gross National Product (GNP) during the 1950s, to 19.5 percent during the 1960s, to 21.2 percent during the 1970s.

Many believe this growth in federal spending is wasteful or even harmful and should be reduced to leave more room for private spending. Moreover, concern with the growth of federal spending serves as a proxy for more general concern with the growth of government power and the pervasiveness of government regulations.

Rising federal spending has been financed partly by increased federal revenues and partly by persistent federal deficits. In fiscal year 1980, the federal budget will be in deficit for the eleventh straight year, the nineteenth time in the last 20 years, the forty-second time in 50 years. The size of deficits has also increased during the postwar period. As a percent of GNP, the average federal deficit during the 1970s was about double the average during the previous decade.

To many people, persistent deficits symbolize a lack of discipline that enables the Congress to enact spending programs without simultaneously increasing taxes. Moreover, many people believe that federal deficits cause inflation, either by "crowding out" the private sector investment that would increase the supply of goods and services and the level of productivity or, more directly, by forcing the Federal Reserve to increase the money supply in order to buy up the new federal debt. Recent escalation in inflation--even though it is largely associated with world oil prices, high interest rates, and other events outside the control of the Congress--has focused attention on the inflation-creating potential of federal deficits.

The case for a constitutional amendment rests on the contention that our present political system is biased in favor of increased spending and deficits. The benefits of a particular federal program tend to be concentrated on a small group, each member of which stands to gain substantially from the program, while the costs are spread over a large number of taxpayers (or victims of inflation), each of whom will lose only a little. Hence, elected officials are in a difficult position: if they vote against a program increase or champion a cut, they will encounter the vocal and **well-organized** opposition of the program's **beneficiaries** without earning more than a weak nod of approval from those who see their share of total taxes reduced by a small amount. Thus, it is argued, the political pressures on the Congress do not reflect the real desires of the electorate, and a constitutional amendment is necessary to redress the balance in favor of reduced spending and budget discipline.

## The New Budget Process

This allegation of spending bias had much validity as long as spending and tax bills were voted on one at a time and the Congress had no opportunity to debate or vote on the overall size of the budget or the magnitude of the deficit. But since the implementation of the Congressional Budget Act of 1974, the Congress has required itself to consider and adopt overall spending totals and to vote explicitly on the planned deficit or surplus. Under the new procedures, those who would add to spending must visibly add to the total of expenditures and the deficit or must propose compensating cuts or tax increases.

It is still too early to tell what effect this new process will have on spending and deficits. The process was implemented during the most severe recession since the 1930s. Much of the expenditure growth and deficits of the past four years can be attributed to the effect of the recession on the budget and the planned fiscal policy that the Congress adopted to speed the recovery. Many believe that expenditures would have grown faster and deficits have been even larger if the budget process had not required explicit votes on spending totals and the deficits.

I believe that the process does **provide** the tools for balancing the budget and controlling expenditure growth. This session, for the first time in 12 years, the Congress will vote a balanced budget. To accomplish this, the Congress is being asked to strengthen the budget process further by invoking reconciliation as part of the first budget resolution. This procedure, if it is accepted by the House, would require eight House authorizing committees to report out by June 15, 1980, legislation that would lower spending by $9.1 billion in fiscal year 1981. The various authorizing committees will retain their power to determine which legislative savings are reported, and the House and Senate will still be free to reject or pass the reported changes.

As long as the budget process operates one year at a time, however, it will be difficult to achieve significant cutbacks without causing major hardships, leaving projects unfinished, and creating disappointed expectations. If the Congress is to cut spending in an orderly way, it must plan several years ahead and must seriously consider phasing out and restructuring programs and reducing the rate of growth of entitlements. The Long Amendment to the Debt Limit bill earlier this year was a first step in multiyear planning, but the Congress has yet to adopt an organized and coordinated plan for making cuts over several years.

Although a multiyear approach would allow the Congress to plan cuts, a constitutional formula requiring annual balance or restricting overall growth would force last minute, unplanned cuts as changing economic conditions caused federal outlays to rise and revenues to fall. It seems sensible, therefore, that before moving to a constitutional amendment the Congress should give its new process a chance.

## Impact of a Balanced Budget Rule on the Economy

When the economy is close to full employment and the utilization of plant capacity is high, a federal budget deficit can add to short-run inflationary pressure by increasing aggregate demand for goods and services, and can exacerbate long-run inflationary tendencies by crowding out private investment needed to expand productive capacity. In the late 1960s, for example, unemployment was low and factory operating rates were high. Nevertheless, because of increased spending for the Vietnam War and an unwillingness either to curb other government spending or to raise taxes significantly, the federal deficit rose sharply. Not surprisingly, the inflation rate tripled between 1965 and 1969. Requiring budget balance in this period would have helped to avoid overheating the economy and accelerating inflation.

When the economy is sliding into a severe recession, however, attempting to balance the federal budget will almost certainly make the recession worse. Deficits occur automatically in recession since declining incomes produce lower federal revenues and spending for unemployment compensation rises. At such a moment, raising taxes or cutting spending in order to balance the budget would reduce aggregate demand further and throw additional people out of work.

In fiscal year 1975, for example, the federal budget deficit rose sharply as the economy turned downward in response to escalating oil prices and other shocks. The federal deficit offset part of the decline in aggregate demand and helped to reduce the depth of the recession. Simulations on the econometric model of Data Resources Incorporated indicate that balancing the federal budget in both 1975 and 1976 would have raised the jobless rate by more than 3.5 percentage points--that is, well over 3 million people--to 11 percent of the labor force, and would have delayed the recovery a full year. The additional economic slack, however, would have reduced the inflation rate by perhaps 2 percentage points in 1976 and 1977.

To require that the federal budget always be balanced is to give up a powerful tool for influencing the economy, especially at the beginning of a severe recession, and to shift the responsibility for stabilizing the economy entirely onto monetary policy. Rather than cast aside such a potent tool for fear that it may sometimes be misused, the Congress should explore ways to preserve discretion over fiscal policy while making it less vulnerable to misuse. The debate and explicit votes on budget deficits that are part of the new budget process should reduce the frequency of ill-timed budget imbalance.

Perverse Incentives of Constitutional Limitations

' Constitutional limitations on federal spending or budget deficits would probably not reduce pressures for new federal activities, but might well change their form. The Congress could avoid the budget limits altogether by using the regulatory power of the federal government to force the private sector or states and localities to bear the cost of new programs. Employers, for example, could be asked to bear the major cost of national health insurance. New off-budget agencies or government-sponsored corporations could be created. Increasing use could be made of federal loan guarantees or other devices to allocate private credit to activities deemed especially desirable by the federal government. A constitutional limit on expenditures would also be likely to encourage the use of tax expenditures to provide subsidies to particular activities. Indeed, even without such a limit, subsidies granted through the tax code have been increasing at a faster rate than outlays in recent years--to an estimated $181 billion in fiscal year 1980.

One effect of the new budget process has been to draw Congressional attention to the current magnitude of tax expenditures, off-budget agencies, and credit activities of the federal government and to increase efforts to bring these activities within the purview of the budget process. CBO believes that Congressional control of the full range of federal activities would be enhanced by bringing off-budget spending agencies back on budget, by compiling a credit budget showing various loan and loan-guarantee activities of the government, and by reviewing tax expenditures on the same basis as direct expenditures. Public decisionmaking is improved and accountability is enhanced when the activities of government are as visible as possible and trade-offs among them can be explicitly considered.

From this point of view, a constitutional amendment would be a step backward. It would encourage the Congress to hide federal activities in off-budget agencies, to control through regulation, and to subsidize through the tax code. The power of the federal bureaucracy might well increase as accountability to the public was reduced.

In sum, I believe that the Congress has made enormous progress since the passage of the Congressional Budget Act of 1974. I urge those who believe in balancing the budget and holding down federal spending to work to strengthen and improve the present process, to use it, and to give it a chance before turning to a fixed rule that might set back progress toward accountable government and that could not be changed without the agreement of two-thirds of the House and the Senate and three-fourths of the states.

# APPENDIX

Additional Comments on Constitutional
Amendments to Limit Federal Expenditures

The formulas of the various expenditure limitation proposals before the Congress can be grouped into four categories: (1) those that set a fixed maximum percentage growth rate for expenditures; (2) those that tie the maximum growth rate of expenditures to the growth of the economy; (3) those that limit expenditures to a percentage of the economy; and (4) those that add a penalty to their formula if an economic target--such as 3 percent inflation--is not met.

Fixed percentage growth rate formulas would either require dramatic cuts in real spending levels during periods of high inflation, or would not significantly limit expenditure growth during periods of low inflation. The other three types of formulas could severely restrict the Congress's ability to respond to a recession.

Federal budgetary expenditures are sensitive to economic conditions; for each percentage point rise in the unemployment rate, total outlays will increase from $5 to $7 billion as payments for unemployment insurance, Social Security, food stamps, and other countercyclical programs grow. Unless the Congress chose to set aside the limit, other programs would have to be cut to make room for these additional monies.

Some proposals--such as H.J. Res. 45, H.J. Res. 75, and H.J. Res. 395--tie the limit to a measure of the size of the economy or to its rate of growth. In both cases, the limits become more restrictive during a recession. Thus, at the very time when you might want greater expenditures to stimulate the economy, these formulas would require cuts. Tables 1 and 2 give some idea of the magnitude of the required cuts that would be brought on by a hypothetical severe recession. We tested the formulas of three proposals under two sets of economic assumptions: those that underlay the five-year targets of the Senate Budget Committee's First Resolution for Fiscal Year 1981, and a hypothetical recession in fiscal years 1980 and 1981 of the magnitude of the 1974-1975 downturn. These estimates are for illustrative purposes only; they were made assuming that the economic targets were achieved either through tax policy or other forces in the non-federal sector, and that the Congress chose not to set aside the expenditure limit. As you can see, the cuts in expenditures required by the decline in GNP are much greater than the higher outlays resulting from increased unemployment. It would seem, therefore, that periods such as this year, when most economic forecasters foresee a recession, would be a particularly difficult time to implement any formula tied to GNP.

Tying expenditures to predicted GNP would create intense pressures on the budget committees and on organizations such as CBO to produce optimistic GNP projections so that additional money might be spent. In the CBO forecast that was released this spring, for example, nominal GNP was projected to be between $2,860 and

TABLE 1. HOW THREE EXPENDITURE LIMITATION FORMULAS BECOME MORE RESTRICTIVE AS THE ECONOMY DECLINES FOR FISCAL YEARS 1981-1984: (In billions of dollars) a/

| | 1981 | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|---|
| Change in Projected Outlays Caused by Increased Unemployment and Lower Inflation | | | | | |
| Unemployment effects | 10.0 | 10.5 | 10.9 | 11.2 | 11.5 |
| Inflation effects | -0.6 | -2.1 | -7.6 | -14.9 | -24.0 |
| Net change | 9.4 | 8.4 | 3.3 | 3.7 | 12.5 |
| Amount by Which Limit Is More Restrictive Because of Poorer Performance of the Economy | | | | | |
| H.J. Res. 45 | 0 | 5.0 | 23.0 | 53.0 | 91.0 |
| H.J. Res. 75 | 0 | 11.0 | 39.0 | 61.0 | 87.0 |
| H.J. Res. 395 | 0 | 16.0 | 54.0 | 78.0 | 105.0 |
| Total Amount by Which Limit Is More Restrictive | | | | | |
| H.J. Res. 45 | 9.4 | 13.4 | 26.3 | 49.3 | 78.5 |
| H.J. Res. 75 | 9.4 | 19.4 | 42.3 | 57.3 | 74.5 |
| H.J. Res. 395 | 9.4 | 24.4 | 57.3 | 74.3 | 92.5 |

a/ Assuming full implementation in fiscal year 1981.

TABLE 2. ECONOMIC ASSUMPTIONS ASSOCIATED WITH THE PROJECTIONS OF TABLE 1

| | Actual 1979 | Estimate 1980 | 1981 | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|---|---|---|
| Economic Assumptions Underlying the Senate Budget Committee Five-Year Targets in First Concurrent Resolution for Fiscal Year 1981 | | | | | | | |
| Nominal GNP Calendar Years | 2,369.5 | 2,599 | 2,889 | 3,245 | 3,651 | 4,100 | 4,584 |
| Nominal GNP Fiscal Years | 2,313.4 | 2,541 | 2,810 | 3,151 | 3,544 | 3,984 | 4,460 |
| Unemployment Rate Fiscal Year Average | 5.9 | 6.4 | 7.4 | 7.5 | 7.0 | 6.4 | 6.1 |
| CPI Fiscal Years | 10.1 | 13.6 | 10.6 | 8.8 | 8.7 | 8.3 | 7.8 |
| Economic Assumptions Underlying a Hypothetical Recession of the Magnitude of the 1974-1975 Downturn | | | | | | | |
| Nominal GNP Calendar Years | 2,369.5 | 2,544 | 2,695 | 2,942 | 3,213 | 3,486 | 3,757 |
| Nominal GNP Fiscal Years | 2,313.4 | 2,514 | 2,635 | 2,875 | 3,144 | 3,420 | 3,685 |
| Unemployment Fiscal Years | 5.9 | 6.8 | 9.5 | 10.0 | 9.8 | 9.5 | 9.2 |
| CPI Fiscal Years | 10.1 | 13.3 | 9.6 | 7.6 | 6.6 | 5.6 | 4.6 |

$3,086 billion in calendar year 1981. This is a range over which there can be reasonable disagreement. But depending on which end of the range was used in applying the formula, total outlays could shift by $55.2 billion under H.J. Res. 75 and by $73.0 billion under H.J. Res. 395.