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The balanced budget amendment: Clarifying the arguments

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Abstract. From the perspective of a supporter, this paper responds to the several criticisms that have been raised to the proposed constitutional amendment to require budget balance. Economists have concentrated on the loss of fiscal flexibility. This objection is countered by reference to the political inefficacy of attempted budgetary manipulation. Lawyers have concentrated on problems of enforcement. This objection is countered by reference to observed respect to other constitutional rules.

PART ONE

1. Introduction

On 26 January 1995, the U.S. House of Representatives approved a proposed constitutional amendment that requires balance in the budget of the federal government by the year 2002. On 2 March 1995, the U.S. Senate, by a single vote, failed to approve such an amendment. As this monograph is written (March 1995), the proposal for constitutional constraints on deficit financing appears certain to occupy the attention of the public and politicians alike over several years.

This monograph is intended as a possible contribution to the ongoing discussion, at several levels of dialogue, during 1995, 1996 and beyond. It is prompted specifically by the recognition that much of the expressed opposition to the amendment for budget balance is based on serious misunderstandings rather than upon interest-motivated desires to maintain high levels of debt-financed governmental outlay.

As early as 1954, in an unpublished paper, I identified a political flaw in Keynesian macroeconomic policy, and I predicted the regime of continuing fiscal deficits that we have witnessed over the half-century. I did not call explicitly for a constitutional amendment, but by the time I published my 1958 book on public debt, the constitutional implications were clear. In the early 1960s, Gordon Tullock and I examined the constitutional foundations of democracy in general terms, and also in the early 1960s, I discussed more explicitly the proclivity of democratic process to generate regimes described

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by "easy budgets and tight money". As we came to observe continuing deficits, Richard Wagner and I spelled out both the history and the analysis in our 1978 book, *Democracy in Deficit*. Various proposals emerged in the 1970s, 1980s and 1990s, all aimed at constitutional correction. I expressed my personal support in legislative hearings, documents, papers and books.

I do not parade this long record of personal involvement to promote my books or to establish my bona fides. I do so to suggest that my current position, along with that of a relatively small number of coauthors, colleagues and students, does not reflect some belated recognition of the deficit as an issue, born out of concern about the fiscal profligacy of the 1980s. The structural flaw in our fiscal politics did not arise in the 1980s, and it will not go away in the ordinary politics of the 1990s and beyond. The structural flaw requires structural correction, that is, constitutional constraint that will, effectively, change the basic rules for the fiscal game.

I shall proceed as follows. In Section 2, I summarize the history of attitudes toward budget balance in order to tell us where we are and how we got to the here and now. In Section 3, I show that the ordinary politics of majoritarian democracy cannot get the deficit under control, despite the noblest of efforts. The incentive structure of this politics is such as to insure the dissipation and any gains that might be achieved temporarily. Section 4 presents the basic analysis of the constitutional rule for budget balance, with emphasis on the necessary distinction between choices among rules and choices within rules – a distinction that is missed by many in the current political dialogue. More specifically, stress is put on the intertemporal feature that makes any budget balance rule especially difficult to put in place. In Section 5, the critical distinction between the fiscal adjustments that the adoption of such a rule makes necessary over a transition period and the adjustments that are required on a permanent and continuing basis is examined. And I advance the argument for temporally lagged implementation of any constitutional rule for budget balance.

Part Two shifts attention to possible criticisms that have been advanced against adoption of the constitutional amendment. The first argument, treated in Section 6, is the one that suggests rejection of the proposed amendment based on the notion that it is inappropriate for inclusion in the general constitutional structure. In this section, I make a separation between the "clean" amendment for budget balance and the sometime proposals that include constitutional requirements for qualified majorities in tax legislation. I suggest that complementary advocacy of such tax and/or spending limits serves to sow confusion – even among those who have been among the strongest advocates of the basic amendment.

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In Section 7, I move on to consider the argument most often advanced by economists – an argument that suggests academic residues of the Keynesian rationale for fiscal fine tuning. Section 8 examines the arguments that emerge from legal-political sources that defend the status quo by reference to issues involved in the enforcement of any fiscal rule. In Section 9, I briefly analyze a sophisticated "supply-side" argument that was advanced in the 1980s and which reappeared in the 1990s in support of the complementary tax and spending limit supplements in the basic rule. Section 10 briefly discusses capital budgeting as it may apply to the proposal rule. Section 11 examines the specious social security argument that was used by opponents to defeat the amendment in the U.S. Senate in early 1995.

In Part Three, Section 12 returns to positive discussion with examination of some of the macroeconomic implications of an operative regime of budget balance. In Section 13, the monograph is concluded with a general discussion of the symbolic significance of the adoption of a constitutional rule for budget balance.

2. How and why we got here

The budget of the United States federal government has not been balanced since 1969. And despite rhetoric about fiscal responsibility and despite occasional short periods during which the size of the deficit has been reduced (the Gramm-Rudman years of the second Reagan term and the Clinton years after the 1993 budgetary legislation), there is little or no expectation that a regime of budget balance will somehow emerge to replace the quasi-permanent regime of fiscal deficits.

How and why did the United States political structure get into this pattern of acknowledged fiscal irresponsibility? If we understand how and why we got here, we may begin to understand how we might get out.

The first century and one-half of our national political history did, indeed, embody a norm of budget balance. This rule was not written into the constitutional document, as such, but rather it was a part of an accepted set of attitudes about how government should, and must, carry on its fiscal affairs. Politicians prior to World War II would have considered it to be immoral (to be a sin) to spend more than they were willing to generate in tax revenues, except during periods of extreme and temporary emergency. To spend borrowed funds on ordinary items for public consumption was, quite simply, beyond the pale of acceptable political behavior. There were basic moral constraints in place; there was no need for an explicit fiscal rule in the written constitution.

The balanced budget norm is ultimately based on the acceptance of the classic principles of public finance. Government borrowing offers a means

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through which burdens of paying for current public spending can be transferred forward through time and placed on the shoulders of those "future generations" who will be subjected to the taxes required to service and amortize public debt.

These elementary principles were overlooked in the Keynesian macroeconomic theory developed in the 1930s and 1940s. The government budget was seen to offer an instrument through which a wise and benevolent government could fine-tune the economy so as to promote the commonly-desired objectives of full employment and economic growth. In this vision, any constraint on the exercise of governmental discretion in setting rates of taxes and spending could only reduce the efficacy of the macroeconomic enterprise.

In order to sell the Keynesian policy prescriptions, the moral onus on government debt and deficits had to be exorcised from public consciousness. For this purpose, the intergenerational effects of public debt-financing had to be denied. Such a denial was allegedly accomplished by concentration on macroaggregates to the neglect of the necessary reduction of costs and benefits to the individuals who lose and gain. By the claim that debt financing did not impact negatively on future-period taxpayers, the moral constraint that had acted to insure fiscal responsibility was eroded and nothing emerged to take its place. The natural proclivities of democratically elected and constituency respondent politicians to spend and not to tax were allowed free play.

The economists were converted to the Keynesian mind-set by the 1940s, and they launched their advocacy of fiscal profligacy in the name of the potential achievement of widely acclaimed objectives, while wearing romantic blinders concerning the motivations of those who must make fiscal choices. The politicians themselves were, at first, reluctant to shed off the shackles of the old-time fiscal religion, but, by the 1960s, they too had come to realize that there were no dramatic negative feedbacks. The regime of permanent and accelerating deficits became a part of our political reality.

Understanding why and how we got here is easy. How to get back to where we were, as described in our moral attitudes toward imposing burdens on future taxpayers, becomes central to the whole debate about the proposed constitutional amendment.

3. Why ordinary politics cannot balance the budget

If fiscal irresponsibility could, indeed, be laid at the feet of particular politicians or parties, there might be some expectation that, with electoral rotation, those who stand for fiscal integrity might eventually replace those who are fiscally profligate. But such expectation could only be utopian. The fault lies not in ourselves, as participants in the ordinary politics of modern majori-

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tarian democracy, but in the structural rules within which this politics takes place.

As they now exist, these rules allow our political agents to escape the discipline of opportunity cost. Government spending for a wide array of "goods" may be authorized, and every one of these "goods" may be valued positively by some or all constituents. The approval of these rates of spending may, however, proceed without explicit regard to the genuine opportunity cost that must ultimately be measured in the sacrifice by someone, sometime, of other values that might have been produced. It is not the public spending, as such, that is the proper focus of attention here. (The normative question of the dividing line between political and private resource use may be important in its own right, but its introduction into the argument on the decision structure can only be misleading.) That which makes the existing rules generate patterns of outcomes that we deem to be irresponsible is the political agents' authority to *spend without taxing*. Little or no sophistication is required to recognize how different the dynamics of fiscal choice would be in a constitutional setting that forced politicians to levy taxes to cover outlays.

The residual Keynesians in our midst, who remain locked into macroeconomic illusion, may continue to suggest that the opportunity costs of public spending must always be borne contemporaneously with the spending itself. They suggest that the valued resources are used up as the outlays are made. But they forget that those who actually give up resources do so in exchange for valued claims (interest-bearing government securities) against future taxpayers.

A more sophisticated denial of the simple logic of deficit financing is located in the argument that citizens, and their political agents, do, indeed, face the full opportunity cost of debt-financed outlay because they will, quite rationally, discount the future tax obligations that any issue of public debt embodies. In this argument, the temporal displacement of the costs of public spending need not affect fiscal choices. Within this "Ricardian logic", there need be no concern about failures in the basic rules of fiscal politics.

Politicians may be observed to spend without taxing, while the shortfall is made up by public borrowing. But, it may be asked, why is government different in this respect from a private person, or a firm, who may also be observed sometimes to borrow in order to meet spending needs? An important difference lies in the absence of any assigned liability for future payment for servicing and amortizing public debt. The owner of a government bond holds a claim against the general tax base of the political community, not against the income or assets of some identified person or group. There is no effective presence of future-period taxpayers in current-period political choice settings,

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a presence that might exert some rough balance into the fiscal benefit-cost calculus.

The incentives are such as to generate a regime of fiscal deficits as a necessary consequence of fully rational responses of political agents to the demands of their constituents. This result remains quite robust under many possible variations in the definitions of political rationality and in the composition of political coalitions. There are, of course, upper limits on the natural proclivity of constituency responsive political agents to create fiscal deficits. But the margin between tax and debt financing that comes to be established in a political equilibrium is well beyond any margin that might be dictated by choices that fully incorporate the present-period interests of future-period taxpayers.

To this point, I have discussed only the direct incentives that exist to bias fiscal choices toward deficit financing of public outlay. These incentives are supplemented by a secondary set which serve to make efforts to behave responsibly in some long-term fiscal sense seem folly. Assume, heroically perhaps, that a majority of elected political agents, acting on behalf of their constituents, comes to acknowledge the long-term damage of continued deficit financing, and that this majority takes effective action toward reducing or eliminating the imbalance in the budget. Such praiseworthy enterprise would necessarily remain vulnerable in the face of electoral rotation. If the responsibly-acting majority coalition could be assured permanence or quasi-permanence in positions of fiscal authority, the deficit-reduction effort might well succeed. But, with constitutionally guaranteed electoral periodicity, there is no assurance that deficit reducing actions (tax increases or spending cuts) taken currently will not be dissipated, wholly or in part, by the actions of other majority coalitions in future periods.

To reduce the budget deficit, costs must be imposed on current-period taxpayers and/or current-period beneficiaries of governmental programs. Taxes must be increased, and/or rates of spending must be reduced. There will be predictable electoral feedbacks on those political agents who impose such burdens. Why should current-period agents, even those who fully acknowledge the long-term damage generated by continuous deficit financing, take on the political costs of deficit reduction if they, at the same time, fear that all of their current-period efforts are vulnerable to dissipation by differing political coalitions in future periods? In ordinary majoritarian politics, there is no way through which currently serving political agents can "lock in" or make secure the salutary effects that any action might produce.

This set of secondary incentives reinforces the primary ones. The natural proclivity to spend without taxing becomes even more dominating an influence on choice when current-period political agents recognize that the same

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proclivity exists for and will possibly be influential on those political agents who will become their replacements in later periods.

4. The relevance of rules

Political choices are made within rules. Elections to the U.S. House of Representatives take place every other year. This rule is only one among many that describe the operation of our politics. Who could deny that political outcomes would be different with congressional election cycles of, say, one year, or four years? This illustration suffices to show that rules matter. And because they do matter, we are obligated to consider changes in rules as well as particular policy options available within the set of rules that exist.

We must make a careful and categorical distinction between *choices among rules* (constitutional politics) and *choices within rules* (ordinary politics). The whole discussion about the constitutional amendment for budget balance is marred by a failure to recognize the importance of making this distinction. The proposal is aimed at changing the rule for the game of ordinary fiscal politics. Supporters of the change predict that, under the new rule, fiscal outcomes will be different, and better, than those outcomes now observed to emerge under existing rules that do not require budget balance.

The point of emphasis is simple. Rules constrain the set of admissible choice alternatives. Different constraints (different rules) must thereby generate different patterns of outcomes. And this direct relationship holds even with no change in the identification of the decision makers. The person who sets her alarm clock (a rule) gets up at a different hour from the person who does not set the clock (another rule). It is, therefore, little more than obfuscatory confusion to suggest that, because we shall have the same or similar political agents in authority with or without a formal balanced budget rule, there will be no predicted difference in fiscal behavior.

The rule for budget balance is, however, different in one critically important respect from ordinary rules for ordinary games. Consider an illustrative comparison. Think of a set of poker players who have been playing for some time under a rule that allowed for only stud games. Someone proposes that the rules be changed to allow draw poker to be called by the dealer. The proposed change may or may not be approved, but the point to note is that the *same* persons who played under the old rules are considering the new rules under which they will also expect to continue playing.

A budget balance rule differs in the temporal composition of membership as between the operation of the existing rules and that of proposed alternatives. Under the rule that allows for the generation of continuing deficits, those citizens and their legislative agents who enjoy the current benefits of spending

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without paying current taxes impose costs on all taxpayers who will be around in future periods. The rule for deficits allows current players in the fiscal game to secure differential gains at the expense of future period players. A change in fiscal rules that would require budget balance removes such differential gains for current-period citizens. The primary beneficiaries of such a change are all those persons who will hold membership in the political community in future periods.

This temporal differentiation among prospective losers and gainers under alternative rules for fiscal politics makes any change from the status quo rule for deficit financing difficult to achieve. It is not as if the same set of players are changing the rules under which play will continue. Those persons who expect to leave the game soon – those who have high rates of time discount, and, in particular, those who gain from benefit most directly from debt-financed spending – will oppose any change that promises its benefits only in future periods. The aged pensioner, or her political agent, must oppose the constitutional amendment for budget balance if her position is motivated by economic self-interest.

5. Lagged implementation and transitional adjustment

It is clearly more difficult to secure agreement on a change in the rules of any game while the game is being played than it is to secure agreement on a set of rules before play begins. This relationship applies to the rules of fiscal politics as well as ordinary games. To the extent that is possible, alternative rules should be considered in a setting where individual positions cannot be identified in terms of prospective gains and losses under the operation of particular rules. Ideally, basic change in rules, constitutional change, should be made only behind some veil of ignorance and/or uncertainty that is sufficiently thick to allow the individual to choose among the alternatives without explicit consideration of the particularized distributional impacts.

This consideration alone suggests that proposals for constitutional change should be lagged in the time for full implementation, that they should never be applied immediately when identified distributional effects are maximally predictable. Critics of the balanced budget amendment who suggest that the introduction of time lags for implementation reflect political cowardice either misunderstand the simple logic of constitutional choice or deliberately seek to sow confusion.

Time lags for implementation should be distinguished from extensions in the time period allowed for transition to a new rule. All of the proposals for the balanced budget amendment include a specific period of transition, and, in the version passed by the U.S. House of Representatives in January 1995,

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this adjustment period was set at seven years. The purpose of a transition period is to allow for a gradual adjustment in rates of spending and taxing so as to minimize disruptions in established expectations of citizens, whether as program beneficiaries, taxpayers or their political agents.

There is no logical argument that suggests, say, a seven-year lag in implementation of a balanced budget rule. Clearly, uncertainty about distributional effects will be reduced as the time period for adjustment is extended, and, relatedly, there will be less required adjustment during each particular period. With a deficit of, say, \$210 billion, a \$30 billion first-year adjustment becomes reasonable with the proposed seven-year lag, provided that the constitutional rule operates to insure a continuance of the initial year discipline.

PART TWO

6. Budget balance as a procedural rule

In Part One, I have laid out the arguments in support of the proposed constitutional amendment that requires the federal government to balance its fiscal budget. In Part Two, I propose to discuss separately and in some detail the most prominent objections and criticisms that have been advanced in opposition to the amendment, or in favor of the status quo, which we may think of as the rule for deficit financing. In this section, I shall address the argument based on the claim that a rule for budget balance is inappropriate for inclusion in the "law of the land" that the U.S. Constitution is supposed to represent, and that adoption of any such rule would amount to constitutionalizing a specific economic philosophy. I shall defer until Section 8 the more familiar economists' objection that the proposed rule embodies a particular stance on macroeconomic policy.

The essential distinction that must be made is that between a rule that acts on the *procedures* through which participants are allowed to reach and to carry out decisions and a rule that acts directly on the *outcomes* that any such decisions might describe. A simple example: A rule that all motor vehicles must drive on the right side of two-way roads in the United States is *procedural*. It does not, in any way, dictate or prohibit any particular pattern of road usage. By contrast, a rule that prohibits large trucks from usage of residential streets is nonprocedural or *substantive* because it operates directly on the set of permissible outcomes that may be generated by the behavior of the vehicle operators.

In the context of democratic politics, most of the rules that we normally classify to be constitutional are procedural. The constitutional rules define the processes within which political action takes place. Every citizen is granted

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the voting franchise; legislative agents are chosen by pluralities or majorities in elections that are scheduled regularly on predictable calendars. Once these and other procedural conditions are met, the basic rules remain silent on the wide ranges of outcomes that may be produced within their limits.

When viewed in this perspective, a constitutional rule for budget balance is procedural rather than substantive. Such a rule does not constrain either the overall size of the public sector (the budget) or the composition of the activities within that sector. Outcomes are allowed to emerge from the interaction of the various cooperative and conflictual pressures that describe the workings of ordinary majoritarian politics. Both proponents and opponents of the balanced budget amendment may, of course, apply their own evaluative standards to specific patterns of outcomes, however these may come about. But it is not legitimate to introduce evaluative criteria applicable for outcomes when directly assessing alternative procedural constraints.

The proposed balanced budget amendment lays out a new rule for making fiscal choices; it does not lay down guidelines for what these choices might be. In one sense, the proposal may be too simple to be understood. In its bare-bones formulation, the amendment requires only that congressional majorities, within the other constraints through which they are authorized to act, pay for what they spend, with "pay for" being defined in a willingness to levy taxes on those citizens who make up the current membership of the polity. By extension from everyday private life, the procedural norm here is simple indeed. Each person or family knows that it must pay for what it buys, and the background law that enforces this precept seldom enters into private consciousness.

Why should the body politic, through government, be allowed to behave differently? They are enabled to do so, in the absence of a constraining rule, only through the legally recognized organic life of the collectivity. A person or family cannot place future persons in indebtedness. Existing claims on a decedent are honored only against the value of assets held at death. There is no burden of private debt that may be transmitted intergenerationally.

Not so with government or public debt. Government remains alive through time, and their obligations are legally honored and enforced, even as the membership of the polity transforms itself through birth, life and death. Recognition of this basic distinction between the private and the collective economy provides the ultimate foundation for the budget balance rule which converts the collectivity into an analogue of its private counterpart.

At this point it is appropriate to discuss briefly that version of the balanced budget amendment that was debated, but not passed, by the U.S. House of Representatives in early 1995 – the version that included the supplementary constitutional provision that all taxes should be approved by a three-fifths

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majority in both houses of Congress. Advocates of this version failed to make the procedural-substantive distinction that I have noted in this section. A constitutional rule that requires a three-fifths majority for *all* fiscal actions would remain procedural, since there is nothing constitutionally sacrosanct about simple majority decision making as such. But, as presented, the qualified majority was aimed to apply only to taxing decisions, a requirement that clearly represented an attempt to introduce substantive direction as to how the federal budget was to achieve and to maintain balance. Such a supplementary rule would have been inappropriate for inclusion in a constitutional structure that is best confined to procedural rules. And this evaluative conclusion holds quite independently of any separate judgment about the urgent need to keep the growth of the public sector within bounds.

7. Politics, policy, and budget imbalance: Response to the Keynesians

The argument that is most frequently advanced in opposition to the amendment centers on the loss of flexibility under a regime that requires budget balance. There is no dispute about the claim that the proposed rule would act to constrain fiscal choices. At issue is whether or not such constraint is desirable.

Whose choices are constrained by the enforcement of a balanced budget rule? The direct influence is exerted on the choices of those persons who are placed in the roles of fiscal agents for the collectivity, the politicians and bureaucrats who are authorized to make decisions on taxing and spending. The question to be resolved concerns the model to be used in understanding and predicting the behavior of these political agents, both individually and as they interact in complex institutional structures.

There is a long philosophical tradition in which the whole activity or enterprise of politics is modeled in an idealistic way. Political agents are implicitly presumed to be both benevolent and omniscient. They seek only to further "the public interest" in some inclusive, aggregative sense, and, perhaps more importantly, they are presumed to know precisely what this interest is. In the extreme version of this conceptualization of politics, *any* constitutional constraint on potential choices of agents must act to forestall or prevent some actions that would otherwise be beneficial for members of the community. Why, for example, should benevolent and omniscient governments ever be required to seek electoral approval for their actions? And, of course, such political agents should never be constrained in their access to particular institutional tools that might be used to further the public interest, as defined. Clearly, the budget, described as the composition of taxing and spending flows chosen on behalf of the collectivity, is a tool that might

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be used, in whole or in part, to achieve designated objectives. Any constraint imposed constitutionally necessarily reduces the ability of political agents to use the budgetary tool. By the very presupposition of this romantic model of politics, a constitutional constraint *could never* improve patterns of fiscal outcomes; at best, such a constraint would simply be ineffective.

It is from within this time-honored tradition of idealized politics that the whole Keynesian theory of fiscal policy emerged during the middle decades of the twentieth century. Keynes did not seriously think about the political institutions through which budgetary decisions are implemented. The "presuppositions of Harvey Road" embodied the notion that macroeconomic policy is to be made by a small, select and sophisticated elite, whose members are both fully informed and personally disinterested in securing private advantage.

The Keynesians – the whole group of economists, publicists and politicians who adopted the proffered nostrums as guidelines for practical policy – were particularly naive in their extension of the norms to the American political setting described by the division of power between the executive and legislative branches and without the party discipline of the British parliamentary regime. In a post-public choice retrospective evaluation, it is difficult to understand how anyone could have imagined that fiscal fine-tuning could be within the politically possible.

Quite apart from the neglect of political-institutional practicability, basic macroeconomic obstacles to the efficacy of fiscal fine-tuning were recognized early in the post-Keynesian dialogues. The fiscal budget, even if all issues of political pressures are overcome, remains a crude instrument, and the effects of budgetary manipulation emerge only after significant time lags. An observed deficiency in aggregate demand may prompt tax cuts or spending increases, thereby increasing the deficit, but by the time the effects of such changes take place, other forces may obviate the presumed need for the fiscal action.

A more persistent, and coherent, source of opposition to the balanced budget amendment is concentrated on the potential efficacy of built-in budgetary flexibility. If elements in the tax and expenditure structures are such that increased or reduced deficits (reduced or increased surpluses) emerge as a matter of course during either recessions or inflations, these budgetary changes serve as stabilizing forces that influence the macroeconomy to return to its predisturbance equilibrium.

This argument has considerable persuasive force if the balanced budget rule is framed and interpreted so strictly that *ex post* or end-of-period accounting equality between revenue intakes and outlays is enforced. If the rule requires that, in the event of an *unanticipated* shortfall of revenues behind outlays,

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due to a reduction of anticipated revenue collections or to an unanticipated increase in rates of outlay, corrective adjustment must be introduced retrospectively as it were, then the operation of the rule would exacerbate the macroeconomic disturbance that might have generated the budgetary shortfall in the first place.

A more acceptable, and less stringent, interpretation of budget balance, as a basic choice rule to be constitutionally implemented, involves no such difficulty. The rule might require only that the final budget resolution, as approved by the Congress and the President, contain revenue and outlay estimates that are equal, as based on competently prepared and unbiased projections at the time of fiscal choice. If, subsequent to choice, that is, to the approval of the budget, the macroeconomic setting should change so as to generate shortfalls or surpluses, these shifts, in themselves, need not be considered to violate the constitutionally mandated rule for maintaining budgetary balance.

In the event that the budget for subsequent periods must be chosen under modified macroeconomic circumstances, implementation of the rule, as such, might require budgetary tightening (on either the taxing or spending side) relative to the prior period, whereas the standard Keynesian prescriptions dictate the opposing direction of change. But the whole hypothetical scenario here can only be grounded on some presupposition about the inefficacy or inoperability of monetary policy instruments in combination with assumptions about the tendencies of the economy toward macroeconomic instability. In a setting in which the central bank fulfills its primary responsibility and keeps the value of the monetary unit stable (within narrow limits) and in which the government budget is balanced, major internal sources for instability are eliminated. The balanced budget rule would, in itself, be an important stabilizing element that would provide an expectational anchor against the fiscal adventurism of impermanent political coalitions.

8. Enforcement and implementation

The opposition to the proposed constitutional amendment for a balanced budget discussed in Section 7 stems directly from economists who have not fully escaped from the intellectual straitjacket imposed on their discipline by the Keynesian revolution of mid-century. A second main source of opposition emerges primarily from the legal community, from constitutional lawyers and legal practitioners, whose human capital has been invested in understanding and interpretation of the constitutional status quo. To members of this group, *any* change in existing rules of the political-legal order must act to create a setting that remains unexplored and unfamiliar. Natural instincts suggest

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opposition to any radical change, which, indeed, the proposed amendment represents.

At the intensely practical level, the legal opposition to the balanced budget rule targets the alleged ambiguities surrounding the enforceability of the amendment. Much of the argument here seems to be deliberately obfuscatory and appears to be a smoke screen for suppressed ideological objections. By contrast with the economic arguments discussed above – arguments that do express serious misgivings about how the proposed rule might work in its effects on macroeconomic policy – the enforceability arguments seem, at base, to be relatively empty and not worthy of consideration except for their apparent success in introducing uncertainties in the attitudes of persons who might otherwise support the amendment.

The first, and elementary, point to be made is that any rule (law, constraint), once put in place, will necessarily provide incentives for violation, either openly or covertly. This effect is inherent in the notion of a rule. The logical grounds for imposing a rule for budget balance is the need to constrain government's proclivity to spend without taxing. The enactment of the rule will not, directly, reduce or eliminate the pressures brought to bear on fiscal decision makers. They will remain vulnerable to demands for spending increases and tax cuts. Faced with the presence of an operative rule for budget balance, these political agents will try to accomplish their purposes by avoidance and evasion when opportunities permit. Efforts will be made to shift programs off budget and to secure regulatory objectives through nonfunded mandates aimed at both private and public units. The acknowledgement that a rule for budget balance would increase the activities of political coalitions along avoidance-evasion dimensions does not, however, support the conclusion that such a rule would not succeed in imposing fiscal constraint. No law could pass that demands perfect enforcement.

A more suspect argument against the amendment takes the form of scare stories about possible means through which enforcement might take place. At issue here is not the predicted efforts of legislative and executive officers to avoid the force of the rule, but rather the processes that may be called into being when and if such agents openly defy or disregard the constitutional prohibition on deficit financing of governmental outlay. What would happen if the Congress and the President simply proceed to approve a budget that violates the constitutional prohibition on deficits? Would the Supreme Court then act on its own and order cuts in rates of spending and increases in taxes? Or would it direct the President to impound funds as necessary to bring the budget into compliance with the constitutional requirement?

When such concerns as these are raised, the implications for the ultimate division of political authority may seem to become threatening. Who could

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support a constitutional change that promises to open up yet another area for judicial intrusion?

Such concerns seem misplaced when we look at the operational experience of American democracy. The institutions of governance – executive, legislative, judicial – have long operated within established, and time honored, constitutional limits. The basic "rules of the game" have only rarely been breached. Elections are organized on schedule; majorities or pluralities effectively determine outcomes; the electoral succession of political representatives occurs peacefully; military authority defers to civilian control.

Why should anyone predict that the Congress and the President would behave differently under the constraints imposed by a new rule that requires budget balance? Why should a Congress defy this rule any more readily than it would refuse to honor electoral results? The very fact that such a rule would be *constitutional*, and understood as such, would seem to be sufficient to guarantee basic adherence.

9. Budget deficits and tax increases

In this section, I shall examine an argument that was important in persuading the Reagan administration against promoting a balanced budget amendment in the early 1980s – an argument that also fostered acquiescence in the mounting fiscal deficits of that period. The same argument resurfaced in support for the inclusion of direct tax or spending limits in the amendment as proposed in 1995. For identification of the argument addressed here, the fiscal stance associated with Milton Friedman may be noted.

In a sense, the argument is not correctly classified among those advanced in opposition to the constitutional amendment for budget balance. The argument is less direct, and it is aimed at reasons for advocacy of the rule. The argument challenges the basic presupposition behind the support for the rule of budget balance – the presupposition that budget deficits, as such, are the center of normative concern. Instead, the claim is that deficit financing, in itself, is irrelevant. The modern variant of the ancient Ricardian theorem is adduced – a theorem that equates debt and tax financing of public outlay through the rational calculus of citizens who fully discount the expectations of future period taxes that any issue of debt embodies. The variable that deserves exclusive attention is the rate of government spending rather than the manner of its financing. Will aggregate outlay be larger or smaller under debt financing? The argument of the early 1980s was to the effect that the Congress might fear increases in the deficit more than increases in taxes, and, as a result, deficit financing might actually slow down rates of approval for ever-larger budgets.

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This position is seriously flawed on at least three counts. First of all, and as noted earlier, it ignores the burden that the payment of interest charges places on future-period taxpayers. Second, it presumes, quite naively, that political agents are more willing to levy current taxes on constituents than they are to authorize public borrowing. Finally, there is the implicit failure to separate fiscal choice-making at the postconstitutional and the constitutional level.

In retrospect, the political-fiscal experience of the early 1980s seems bizarre. The diversion of attention from budget imbalance almost guaranteed that the deficits would increase rather than decrease over time. In the 1995 discussion, the Friedman argument offered analytical encouragement to those who sought to append the proposed amendment with tax or spending limits, thereby shifting the proposal from the procedural to the quantitative category and providing occasion for totally different sources of opposition.

10. The case for capital budgeting

Critics of the balanced budget amendment often identify the failure to include an exemption for capital spending as a major flaw. Such critics suggest, at least by inference, that the constitutional amendment for balance in the current budget might deserve serious consideration upon the establishment of a separate capital budget account.

The classical (pre-Keynesian) theory of public debt included a normative argument in support of debt financing of lumpy or extraordinary spending on projects that promise to yield benefits over some finite sequence of periods subsequent to that in which the initial outlay is made. By analogy, individual families and business firms finance long-lived assets with debt extending over the income yielding lives of the assets. Persons finance consumer durables, including houses, by debt, and mortgage payments are a large share in household budgets. Firms finance capital improvements by bonds. The argument suggests that governmental units should be constitutionally empowered to behave under roughly similar rules.

Two issues emerge, however, that suggest caution in setting too much emphasis on capital budgeting. First, a distinction must be made between capital assets that will yield income to government (via the taxable income base) over some effective life, and those assets, although physically durable, that may not yield measurably productive increments to the income stream. Such assets should, in principle, be treated quite differently from the first sort in any sound accounting. The argument for separate treatment applies only to the first sort of capital investment assets. Servicing and amortization of debt used to finance the second sort of assets impose net burdens on future-period taxpayers that are indistinguishable from burdens imposed by servicing the

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debt used to finance ordinary public outlay. The fact that there may exist marble monuments that last forever offers no basis for a claim that such edifices are appropriately financed by debt issue.

A second problem emerges even if the capital budget is defined to include only those public investments that do, in fact, generate streams of income, thereby providing sources for debt service. The classical theory of public finance supported debt issue for capital projects only when the spending was predicted to be extraordinary rather than continuous over a whole sequence of budgetary periods. If rates of spending on capital projects that are fully eligible for exemption from period-by-period budget balance requirements are roughly uniform over time, the operation of separate current and capital budget accounts, with only the first subject to the balance mandate, would not be different, in effect, from combination into a unified account – all of which is subject to the balance requirement. In this setting, which seems empirically descriptive of modern fiscal institutions, the argument for the establishment of a separate capital budget, with exemption from the constitutional rule for balance, seems much ado about nothing.

11. Social security trust fund accounting and the amendment for budget balance

This Section was not in the initial outline for this monograph. It has been added only as a response to the U.S. Senate debates in February–March 1995 that resulted in a one-vote failure of the proposed amendment to secure the votes necessary for approval. Opponents of the amendment justified their position by introducing alleged threats that ultimate implementation of the constitutional change would carry for social security programs.

There are two, quite different, claims advanced. The first is to the effect that trust fund revenues should not be used to balance the fiscal budget. This claim is bizarre at best, since all estimates for the size of deficits for the 1990s do include OASI revenues, which, in isolation, generate a surplus over outlays (some $60 billion in 1995). To move to budget balance in seven years, or by 2002, as projected in the program advanced in the U.S. House of Representatives proposal of 1995, both revenues and outlays under the social security program are included. To argue for exclusion of trust fund accounting revenues from the achievement of the initial target for budget balance is to argue that the objective be made more rather than less difficult to achieve.

A second, and quite different, argument is both more direct and more reflective of interest-group pressures on political choices. If the amendment, as proposed, should be ultimately approved, both by the Congress and the required number of states, reductions in rates of projected federal outlays

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and/or increases in rates of taxes will be necessary over the years of transition. Opponents sought to secure specific exemption of social security outlays from any spending reductions made necessary under the generalized austerity regime that implementation of the balanced budget rule would cause. The debate over the efficacy or inefficacy of a constitutional rule for budget balance, a debate that is properly joined along the dimensions already discussed above in Sections 6 through 10, was effectively shifted to argument about budgetary composition, argument that seems totally inappropriate at the level of constitutional discourse.

PART THREE

12. Budget balance and macroeconomic stability

Opponents of the constitutional amendment for a balanced budget have "pulled out all the stops" in describing the horrible consequences that the rule could produce. As discussed earlier in Section 7, much of the argument is grounded in outdated Keynesianism, as this shows up in nonsophisticated models of the economy and in naive models of democratic politics. In part, however, the generalized macroeconomic opposition to the balanced budget rules stems from an elementary misunderstanding of the positive feedbacks on macroeconomic stability that the presence of such a rule would exert. In the language of competitive sports, "the best defense is a good offense". The most effective counter to the macroeconomic opposition arguments may be that which traces how the operation of such a rule will, first, introduce a stabilizing force in the economy, and second, will make the task of the monetary authorities much easier.

Who could challenge the claim that, if it were not for the expectation of continuing deficits, with the ever-present danger-threat of ultimate monetization of public debt, the efforts of the Federal Reserve authorities to squeeze the inflationary premium out of long-term interest rates would be more successful. Lower long-term rates would almost surely accompany implementation of the balanced budget rule, not only because of reduced inflationary expectations, but also because governmental demand for loanable funds would be reduced. And, with lower long-term rates, private investment would be encouraged.

A regime of budget balance, by comparison with a regime of continuing deficits, must embody lower rates of government spending and/or higher rates of taxation. Both of these changes reduce aggregate demand for consumption, private and public, and allow resources adjustment toward increased investment. Given any specified level of macroeconomic activity, under the two regimes compared, the postrule composition of resource use must involve

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a shift toward more investment and less consumption. Only if the "secular stagnation" thesis of the 1930s and 1940s should be revived could such results be denied.

It is perhaps too easy to become strictly provincial in discussions and debates about the possible efficacy of the constitutional rule for budget balance in the United States. Rudimentary attention to the historical experience of other countries and in other times may offer new insights. In almost all cases where economic-social-political stability has been undermined by hyper or near-hyperinflation, generated by disproportionate increases in the quantity of money, the source has been fiscal. Governments have been motivated to spend revenues at rates in excess of their willingness or ability to collect taxes from constituents. To meet emerging revenue shortfalls, governments have, first, made efforts to borrow funds, that is, to finance deficits, by issue of public debt. As revenue shortfalls accelerate, however, lenders of funds (both domestic and foreign) have become wary of governmental credit worthiness. At this juncture, governments face increasing difficulty financing deficits with interest-bearing debt. Faced with such a dilemma, governments have, almost everywhere, resorted to the printing presses, subverting the allegedly independent monetary authorities (national central banks) for political purpose.

These historical experiences from other places and times should never be forgotten when we engage in current constitutional policy discussion in the United States. Participants on all sides of the debates, are likely to presume that "it cannot happen here". But the potential macropolitical disaster that threatens when and if we fail to correct the structural flaw in our decision-making procedures must inform any reasoned attitude.

Finally, related observations concerning possible default on public debt are in order. As interest charges mount under the regime of continuing deficits and in the absence of corrective action as reflected in the proposed amendment, more and more questions must be raised about the moral-ethical status of those claims against productive income earners. Why should taxpayers in, say, 2010, be obligated to pay for public use of resources in, say, 1995? Why should future-period taxpayers be coerced in order to meet fiscal charges that are incurred by present-period program beneficiaries?

These questions, once posed at all, themselves suggest that the moral and, hence, political bases for "fiscal responsibility", as defined by both historical tradition and international agencies, become increasingly insecure as the regime of continuing deficits persists. It is scarcely an exaggeration to suggest that the collective choice is starkly simple: Adopt the constitutional amendment that requires budget balance *now*, or face fiscal-economic-political disaster in the rapidly approaching day of reckoning. Sooner or later, the piper must be paid.

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13. The rule as symbol

The symbolic significance of a constitutional rule for budget balance should not be overlooked. Each person constructs her own image of the society in which she lives, and of her own role in that society relative to those of others through the use of symbols. And these symbols may only in some part mirror the realities that may be revealed by empirical science in its ordinary sense. In the United States, we presume that our society embodies "the rule of law", which, in its familiar representation, means that all citizens are subject to equal treatment under the law. But we also recognize that this interpretation of the rule of law remains in part only symbolic, as expressive of an idealized conception, and that, in the reality of legal practice, the equality norm is often violated. "The law" for O.J. Simpson in 1995 is not that which would have been faced by an ordinary citizen, black or white.

Recognition of the divergencies between the observed realities of social interaction and the idealization of these realities through their symbolic representations does not, however, offer legitimate grounds for rejecting the value of the latter. It may be suggested that the principle for budget balance, as such, remains symbolic of governmental fiscal responsibility. With few exceptions, even the most ardent opponents of the constitutional rule express adherence to budget balance as a norm for sound fiscal policy. And, prior to the Keynesian epoch, the symbolic status of budget balance, as an ideal, was in itself sufficient to limit violation of the implicitly-accepted rule in political reality. There was then little, if any, need to formalize that which was almost universally accepted as a practicable norm.

Viewed from this perspective, approval of the proposed constitutional amendment becomes a reaffirmation of the symbol for governmental fiscal responsibility. The emplacement of this rule, interpreted as a fiscal norm, in the actual written constitution serves dual purposes. Such a rule positively modifies public expectations about the fiscal stance of government in future periods, and, at the same time, modifies the personalized cost-benefit calculus of those politicians who must make ordinary fiscal choices.

In the political climate of the 1990s, before any approval of the constitutional amendment for budget balance, the politician who responds to constituency pressures toward increased spending does so with some conscious recognition of the effects of his or her action on the size of the deficit, and, indirectly, in the burden thereby placed on future-period taxpayers. Continued deficit financing does, indeed, impose *some* opportunity cost on those whose decisions produce such results. But who can challenge the claim the constitutionalization of the moral norm of fiscal responsibility would act so as to increase such cost dramatically? To violate a moral norm is one thing, and especially as one

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decision maker in a large group. To violate a moral norm that also involves breaking a constitutional law is quite another.

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