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A Constitutional Solution to Runaway Federal Spending: The Need for a Balanced Budget and Spending Limits Amendment

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Key Points

- The current federal budget has a deficit in excess of 10 percent of GDP, shattering all records except during World War II.
- Congress continues to borrow a staggering sum of money from the American economy.
- S.J. Res. 10 in Congress would be a good solution, imposing spending limits and a balanced budget requirement on Congress.
- Congress should pass S.J. Res. 10 as soon as possible, so the states can begin ratifying it.

Introduction

The protections for individual freedom in the Constitution of the United States have been significantly weakened since the 1930s. Through periods of GOP as well Democratic majorities, the federal government's authority has increased at the expense of the states and the people. During this time, the federal courts have abdicated their role as guardians of the constraints on federal power, eliminating a vital check-and-balance of our Constitution.

The federal government's progressive expansion at the expense of the rights the Constitution meant to leave to the States and to the people[1] has come in ways big and small, subtle and not-so-subtle. Nowhere is it more obvious than in runaway federal spending. The current federal budget has a deficit in excess of 10 percent of GDP, shattering all records except during World War II. Congress continues to borrow a staggering sum of money from the American economy and from every corner of the world, increasing our dependence on foreign governments, removing needed investment capital from the private economy, and burdening future generations—our children and their children—with a crushing debt. As President Barack Obama himself recently admitted, the federal deficit is among the most grave national security threats we face.

The time has come for Congress to propose, and for the States to ratify, a constitutional amendment that would require Congress to pass a balanced budget. Such an amendment should also contain limitations on taxing and spending, because otherwise the balanced budget amendment could lead straight to tax increases. Fiscal discipline means more than a balanced budget. It will also require lower taxes and spending.

Many in Congress recognize the need for such an amendment. This is why 47 U.S. Senators recently introduced a measure—Senate Joint Resolution 10 (S.J. Res. 10)—that would propose to the States, for their ratification, a constitutional balanced budget amendment with strict spending and taxing limitations. This paper explores the history of federal spending, the threat it poses to our country, and the ways in which S.J. Res. 10 would help restore fiscal sanity and constitutional government in Washington.

The History and Consequences of Federal Spending

The rapid expansion of the federal government within the last century is most obvious in the share of the nation's private wealth that the federal government taxes and spends. In 1930, federal government spending accounted for 3.4 percent of GDP. Franklin Roosevelt doubled the size of the federal budget in his first two years in office. By 1939, on the eve of World War II, the federal budget exceeded 10 percent of GDP and would never again fall below that figure.[2]

During World War II, when the U.S. was on "total war" footing, all our human and material resources were focused on the war effort. War

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bonds nearly tripled the amount of debt held by the public, to a high of 113 percent of GDP in 1945. But the debt fell back quickly, reaching 24 percent of GDP in 1974.[3]

At the end of 2008, the national debt was once again on the rise, reaching 41 percent of GDP, just above the 40-year average. But the projected liabilities of Social Security, Medicaid, and Medicare entitlements, combined with exploding federal discretionary spending of the Obama budgets—almost all of which has been borrowed—has thrown historical trends out the window. As the Congressional Budget Office ominously notes in its June 2009 *Long Term Budget Outlook*, "The systematic widening of budget shortfalls under the CBO's long-term scenarios has never been observed in U.S. history."[4] CBO projects that the deficit, which exceeded 10 percent of GDP in 2010, is projected to take 10 years to fall back to the high end of typical postwar deficits: 5.6 percent of GDP by 2020. As a result of this prolonged record-breaking deficit spending, the national debt could reach 90 percent of GDP by 2020. After that, according to CBO, the debt will continue increasing its proportion of GDP, triggering a vicious circle of potentially devastating economic consequences.

As CBO explains:

> If the ratio of debt to GDP continues to rise, lenders may become concerned about the financial solvency of the government and demand higher interest rates to compensate for the increasing riskiness of holding government debt. Eventually, if the debt-to-GDP ratio keeps increasing and the budget outlook does not improve, both foreign and domestic lenders may not provide enough funds for the government to meet its obligations. By then, whether the government resolves the fiscal crisis by printing money, raising taxes, cutting spending, or going into default, economic growth will be seriously disrupted.[5]

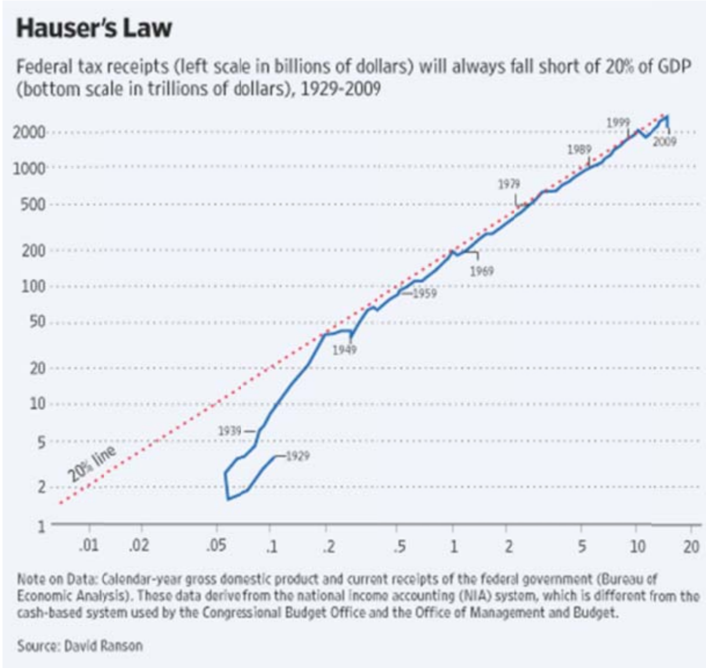
Just as the overall national debt acts as a break on economic growth, so too do federal taxation and short-term borrowing to sustain deficit spending. Deficit spending is often viewed as stimulative. But a dollar taken or borrowed by government is a dollar not spent by the private economy that earned it, so the question is not whether deficit spending is stimulative, but rather whether it is more stimulative than the private spending or investment that could have occurred but didn't.

Taxation, on the other hand, is clearly burdensome to the economy. In fact, beyond a certain point the federal tax burden appears to function as an absolute brake on economic growth. Empirical evidence of this was cited in a 1993 *Wall Street Journal* op-ed (*see next page*) in which Hoover Institution board chairman Kurt Hauser observed that "no matter what the tax rates have been, in postwar America tax revenues have remained at about 19.5 percent of GDP."[6] It appears that the overall federal tax burden, along with state and local taxes, hovers just around or above the revenue-maximizing point of the aggregate tax burden. As David Ranson wrote in 2010, historical statistics strongly suggest that the federal tax burden has "a kind of capacity ceiling for federal tax receipts at about 19 percent of GDP."[7]

The reason for this can be seen in the concept known as the Laffer Curve. As Arthur Laffer famously theorized, every tax must have a revenue-maximizing point somewhere between a tax rate of zero and 100 percent. A tax rate of zero obviously produces no revenue. Laffer's great insight was that a tax rate of 100 percent also produces no revenue, because people will not work for nothing. If all the income from a given activity is taxed, such that engaging in the activity is a total loss, the activity will cease. As taxes are raised on a given activity starting from zero, the disincentive to engage in that activity at some point starts to exceed the incentive to engage in it, and the activity begins to diminish, reducing the taxable base, and hence reducing revenue to the government. That is the revenue-maximizing point. The Laffer theory says that any taxes above that point will reduce both economic activity and revenue to the government, and are always a deadweight loss. Laffer's findings confirm that government spending is a burden on the economy, and that as spending grows—and taxes increase to support that spending—it will eventually reach a level where the burden not only slows economic growth, but actually reverses it.

As government spending has risen significantly above 20 percent, we have seen that it can only be financed through borrowing, which not only increases the national debt but also removes investment capital out of the private economy, forcing private parties to offer higher rates of interest to compete for a smaller pool of investment capital.

Current levels of federal spending and borrowing are unsustainable, particularly those of the major federal entitlement



programs—Social Security, Medicaid, and Medicare—as they drive the federal government and the American economy to insolvency. CBO projections, which presume that federal revenues will stay around 20 percent of GDP for the rest of the 21st century in keeping with Hauser's Law, are sobering. Just the spending on Social Security, Medicaid, and Medicare will exceed 20 percent of GDP—virtually the entire current budget—after 2060.

The need for a constitutional amendment that holds Congress to a balanced budget and strict limitations on taxation, spending, and debt is increasingly obvious.

The U.S. Senate Republican Proposal: Senate Joint Resolution 10[8]

The measure introduced by 47 U.S. Senators—S.J. Res. 10—would address many of the fiscal issues facing our country. It would require Congress and the president to adopt a balanced budget with limited exceptions. It would hold spending to 18 percent of the previous year's GPD, which would both keep federal spending under the historical "maximum revenue" limit of federal tax receipts, and ensure that federal programs won't be able to increase the scope of the federal government. It would require supermajorities for increases in taxes and the national debt. It calls for ratification by three-fourths of the State legislatures, in accordance with Article V of the Constitution, and would go into effect five years after ratification. A more detailed analysis follows.

Balanced Budget and Spending Limitations

The proposed amendment contains several critical budget-related provisions. A balanced budget provision on its own is not enough. Without a spending limit, it would only defend against deficit spending, and could be enforced by a court order to raise taxes. To prevent this, it is vital to combine the balanced budget requirement with strict limitations on spending, taxing, and the debt. Other provisions are also necessary to make sure that the amendment operates as intended. The following provisions in S.J. Res. 10 are carefully crafted to achieve these ends:

- ***Requirement to Pass a Balanced Budget.*** S.J. Res. 10 provides that Congress must pass a balanced budget, unless two-thirds of each House provide for a specific deficit. This is a stricter limit than balanced budget proposals from previous eras, such as in the Reagan administration, which required only a three-fifths majority for any deficit spending. Under this provision, unless a two-thirds super-majority says otherwise, the government could spend not a dollar more than it actually collects in taxes. The super-majority requirement, though strict compared

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to other proposals, would allow the Congress just enough flexibility to do deficit spending in specific cases where it may be urgently necessary.

- ***18 Percent of GDP Spending Cap.*** Congress must limit outlays to 18 percent of the previous year's GDP. This provision is designed to accomplish several things. At a time when Americans are increasingly committed to reducing the scope of government, the federal government is spending a peace-time record 24 percent of GDP. Nearly a quarter of the entire economy's output is now absorbed and controlled by the federal government, higher than at any time since World War II. Few limits on the expansion of federal power could be more effective than an absolute limit on what proportion of the nation's economy can be taken over by the federal government. The spending limitation pegged to 18 percent of GDP is designed to limit the overall scope of the federal government, in part by getting the aggregate tax burden below what appears to be its revenue-maximizing point.

- ***Presidential Requirement to Submit a Balanced Budget.*** Prior to each fiscal year, the President must transmit to Congress a balanced budget that limits outlays to 18 percent of GDP. This provision is necessary to ensure that the executive branch continues to play its key role in the budget process. S.J. Res. 10 would require a great deal of spending restraint and prioritization, and it is vital to make the President transparent and accountable for how he prioritizes among the various competing interests in the sprawling federal bureaucracy. This requirement will also force the agencies themselves to be proactive in prioritizing, finding efficiencies, and showing restraint.

- ***Supermajority for Tax Increases.*** Establishes a new supermajority requirement for net tax increases. S.J. Res. 10 provides that two-thirds of the Members of each House of Congress must approve any new tax, as well as any increase in an existing tax or the aggregate amount of revenue. The provision also provides that, "For purposes of determining any increase in revenue under this section, there shall be excluded any increase resulting from the lowering of the statutory rate of any tax." In other words, the supermajority requirement does not apply to any increase in federal revenue resulting from a tax cut. This is clever provision would constitutionally legitimate the Laffer Curve, by recognizing that any tax cut occurring above the revenue-maximizing point of a given tax will have the effect of increasing revenue to the government—as well as stimulating economic activity more broadly.

- ***Supermajority to Raise the Debt Limit.*** Establishes a new supermajority requirement for an increase in the debt limit. This provision would make the current statutory requirement of a supermajority to raise the debt ceiling a constitutional requirement.

- ***Exceptions for Times of War and National Emergency.*** Most proposals for a constitutional balanced budget and/or spending limitation amendment carry exceptions for cases of national emergency. In S.J. Res. 10, however, the limitations are unusually restrictive, helping to guarantee that the exception will not "swallow" the rule. It provides two exceptions: where there is in effect a declaration of war "against a nation state," and where the U.S. is engaged in a military conflict "that causes an imminent and serious military threat to national security."

    - The exception for declared wars against "nation-states" would exclude wars against terrorist organizations such as Al Qaeda. It would no longer apply to the congressional authorizations to use force against Afghanistan (2001) and Iraq (2003) with respect to the regimes then existing in each country, because the regimes in which question have been removed and both nation-states are now allies of the U.S. In both countries our military forces are now engaged in stability and security operations, though there is still large-scale military conflict in Afghanistan. The "declared war" exception would require a simple majority in both Houses of Congress, but the majority would have to vote for a specific excess of spending over revenue in each fiscal year in which the exception is invoked.

- The exception for military conflicts that cause "an imminent and serious military threat to the national security" would cover all other military conflicts, including the fight against Al Qaeda. The exception would have to be invoked by a three-fifths majority in both Houses of Congress and could only cover the excess spending made necessary by the identified military conflict.

- ***Technical Provisions.*** S.J. Res. 10 contains additional provisions to ensure that (1) where court enforcement is necessary, the enforcement will be through a spending cut rather than a tax increase; (2) Congress cannot artificially increase its spending limits by borrowing to increase revenue; and (3) Congress is allowed to find economical ways to pay down the national debt, such as by "refinancing" on more favorable terms.

Ratification

Provision for ratification by state legislatures. S.J. Res. 10 provides that the constitutional amendment will be valid when it is ratified by three-fourths of the state legislatures. Under Article V of the Constitution, all proposed amendments must be ratified by legislatures or conventions in three-fourths of the states. Congress has traditionally defined whether the method of ratification is to be by legislatures or conventions. However, all of the amendments to our Constitution were ratified by legislatures in the states, with the single exception of the repeal of prohibition (Amendment 21) which was ratified by state conventions. The S.J. Res. 10 follows standard practice in providing for ratification by three-fourths of state legislatures. It provides no time limit for ratification.[9] The amendment would go into effect five years after ratification, allowing Congress enough time to transition from any deficits existing at the time of ratification to a balanced budget without painful economic or social dislocation.

An amendment that requires Congress to adopt balanced budgets, limits its power to tax and spend, and provides narrowly-drawn exceptions for real emergencies, should be a priority for our elected representatives, federal and state.

Conclusion

The American people are increasingly demanding a halt to the expansion of the federal government and in particular to runaway federal spending. To keep the federal government and federal debt from reducing our nation's wealth and depriving future generations of the opportunities and economic liberties that made this country great, a constitutional amendment is now clearly needed. An amendment that requires Congress to adopt balanced budgets, limits its power to tax and spend, and provides narrowly-drawn exceptions for real emergencies, should be a priority for our elected representatives, federal and state.

Congress should enact the S.J. Res. 10 constitutional amendment resolution as soon as possible, so the States can proceed to the ratification of this vital constitutional reform. ✩

Endnotes

[1] The 10th Amendment to the U.S. Constitution provides, "the powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."
[2] Office of Management and Budget, Historical Tables, Table 1.2--Summary of Receipts, Outlays, and Surpluses or Deficits as Percentages of GDP: 1930-2016, http://www.whitehouse.gov/omb/budget/Historicals.
[3] Congressional Budget Office, *The Long Term Budget Outlook* (June 2009) 15, http://www.cbo.gov/ftpdocs/102xx/doc10297/06-25-LTBO.pdf.
[4] Ibid.
[5] Ibid., 14.
[6] Kurt Hauser, "The Tax and Revenue Equation," *The Wall Street Journal* (25 Mar. 1993).
[7] David Ranson, "The Revenue Limits of Tax and Spend," *The Wall Street Journal* (17 May 2010) http://online.wsj.com/article/SB10001424052748704608104575217870728420184.html .
[8] The full text of S.J. Res. 10 available here: http://www.gpo.gov/fdsys/pkg/BILLS-112sjres10is/pdf/BILLS-112sjres10is.pdf.
[9] Amendment 21 provided for a seven-year limit for ratification by the states.

About the Author

Mario Loyola joined the Foundation in July 2010 as Director of the Center for Tenth Amendment Studies and an in-house policy expert within the Armstrong Center for Energy & the Environment.

Loyola began his career in corporate finance law. Since 2003, he has focused on public policy, dividing his time between government service and research and writing at prominent policy institutes. He served in the Pentagon as a special assistant to the Under Secretary of Defense for Policy, and on Capitol Hill as counsel for foreign and defense affairs to the U.S. Senate Republican Policy Committee. Loyola has also worked as a state policy advisor for Senator Kay Bailey Hutchison.

Loyola has written extensively for national and international publications, including features for *National Review* and *The Weekly Standard*, and op-eds in *The Wall Street Journal*. He has appeared on The Glenn Beck Show, CNN International, BBC Television, Radio America, and more.

Loyola received a B.A. in European history from the University of Wisconsin-Madison and a J.D. from Washington University School of Law.

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