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Statement by

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before the

Subcommittee on Monopolies and Commercial Law

of the

Committee on the Judiciary

House of Representatives

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Mr. Chairman, your invitation to discuss the important issue of fiscal discipline, and specifically, House Joint Resolution 350 to amend the Constitution to encourage budgetary balance, has left me with mixed feelings. We face the hard fact that we have had inappropriately large budgetary deficits during much of the post-war period -- and so far we have failed to resolve a truly threatening budgetary gap in the years ahead. Consequently, an effort to correct the apparent bias toward deficits in the political process seems timely. At the same time, I can only be impressed by the difficulty of attempting to write a Constitutional provision to induce discipline otherwise lacking -- a provision that will serve us in fair weather and foul, and in economic circumstances that can only be dimly foreseen.

I must at the start emphasize that the questions we face today about the size of the federal sector, the composition of spending, and its means of financing require resolution long before the time-consuming process of amending the Constitution can be completed. I have often expressed my concern about the critical need to break the inflationary momentum that had come to grip the nation in the 1970s and spoken of the indispensable role that monetary policy has to play in that effort. At the same time, I have emphasized the difficulties that result from placing too heavy a burden on monetary policy alone in that fight on inflation -- difficulties manifested in expectionally heavy pressures on financial markets and interest rates, and therefore on credit-dependent sectors of the economy. Current developments reflect needed progress on the inflation front, but they only reinforce my concern about imbalance in our policy approach -- an imbalance reflected in prospective deficits far larger, taking account of economic activity, than in the past. In the absence of needed corrective action, potential strains on credit markets implicit in the prospective budgetary picture call into question the assumption of healthy economic recovery and growth, upon which even those budget projections are based. And those prospective deficits are a contributing factor in today's high interest rates as lenders and borrowers "discount" their impact on credit market conditions.

The Judiciary Committee is, of course, not the body to address this serious immediate problem. But I can only urge that deliberations on a Constitutional Amendment to provide for a balanced budget not become a kind of substitute or surrogate for the action needed, here and now, to deal with the pressing current situation. The debate will serve us ill to the extent it diverts attention from that present need.

I can only be sympathetic with the basic objectives of the Amendment proposed in H.J. Res 350. A budget surplus has been realized only once in the past two decades and only eight times in the past 50 years. The deficits of the Great Depression and World War II were, by and large, both unavoidable and, in the circumstances, justified. Those particular circumstances as well as developments in economic doctrine, had the effect of discarding the unwritten, but operational, rule that budgets should always be balanced. In the process, some of the traditional disciplines on debt financing were lost. During World War I, Congress put aside the practice of separately authorizing each Treasury debt issue. The "debt ceiling" authorizations that followed have failed to focus debate and provide strong disciplines, partly because that legislation, by its nature, comes at the end of the fiscal process when payments already committed must be made. The budgetary reforms instituted in recent years do seem to me constructive in forcing more attention to the budgetary aggregates and the relationship between them, but they do not appear to have effectively dealt with the deficit problem.

In economic theory, purely discretionary fiscal policy would not be expected to result in deficits following one after another, in good times and bad, in war and in peace. Yet, that is what has occurred in the past two decades. The results seem to me apparent. Over time, inflationary pressures or crowding out of private investment, or both, are the economic costs of inappropriate deficits.

At a different level, one can legitimately question whether loss of a balanced budget discipline has not permitted us to escape hard, but necessary, choices between high and low priority federal spending, at a cost of efficiency and excessive growth of government. That is not an argument that smaller government expenditures are always better than larger, or that "efficiency" should not sometimes give way to widely shared social objectives. The point is that a balance has to be struck, and it should be struck consciously, with awareness of the costs. If the realization or presumption exists that government expenditures over time must be covered by taxes, we are likely to have a clearer "market-like" test of whether a contemplated expenditure really reflects national priorities.

In other words, I share the feeling of the supporters of H.J. Res 350 that the political process, as it has worked in practice, in the absence of a strong presumption that budgets should be balanced, suggests some bias toward more spending and less taxation -- in other words, toward budgetary deficits -- than is healthy for the economy or for governmental efficiency. The cost has been obscured, but it is real -- a bias toward inflation, too little private investment, and possibly toward a federal sector inefficiently large. In principle, economic analysis and wise economic advice could counterbalance a political bias toward deficits. But economics is far from being exact. Economists differ in their policy prescriptions. If plausible economic reasoning can be found to rationalize existing political bias -- or if dispassionate economics merely gives ambiguous results in many instances -- the political bias is likely to prevail.

At the same time, I cannot argue that budgetary balance is always appropriate. The challenge, therefore, is to establish rules or presumptions that will provide discipline but not a straight jacket. That is, as I understand it, precisely what the proponents of H. J. Res 350 seek. In my judgment, they have come closer to that goal than earlier drafters of a Constitutional Amendment. But I am left with an uneasy feeling that a number of unresolved problems remain.

For example, would this Amendment really be of help in the current situation, when a sizable deficit for a few years ahead appears inevitable? Somehow, a 60 percent vote of the entire House and Senate would need to be marshalled for a deficit budget. In concept, the need to marshal that vote would result in pressure to strike a compromise at a smaller projected deficit. But we know there are deeply held convictions about particular parts of the budget, and the process of reconciling those differences might be even more difficult -- leading to an impasse in adopting a budget. I am left with a question about how the impasse might be resolved if a strong-willed majority could not command the necessary 60 percent vote.

In assessing the workability of the proposed Amendment, I suspect much would depend upon the nature and practicality of arrangements to enforce the budgetary decision. There is a lack of specification -- not only in the Amendment itself but in any related material of which I am aware -- of the procedures through which the Congress and the President shall ensure that actual outlays remain within budget totals. The point has added force when we recall the large proportion of federal expenditures made pursuant to entitlements, cost-plus contracts, interest obligations, and so forth. The sponsors may well have in mind such procedures as altered handling of budget rescissions or line-item vetoes. Indeed, such provisions, on their own merits, could go far, by themselves, in correcting some of the political biases now affecting fiscal policy. But such procedures to carry out the mandate of the Amendment would appear to have implications for the delicate issue of the balance between executive and legislative powers. I have no special expertise on these issues, and they go well beyond the purview of the Federal Reserve. But they do seem to me to be worth consideration before the fundamental step of amending the Constitution is undertaken.

I also have reservations about other parts of the Amendment. Section 2, which limits the growth of revenues in the absence of an affirmative vote of the Congress, could have some peculiar implications. There is no obvious economic logic to limiting the growth rate of revenues for budget purposes in a fiscal year to the rate of change of income during the previous calendar year, which might be a year of recession or expansion. Moreover, many specific tax structures would give rise to levels of revenue differing from the amount contemplated by the formulation in Section 2, thus requiring annual re-affirmations of the tax structure. The consequent requirement for relatively more frequent votes on the overall tax structure -- even if only to reaffirm it -- could increase uncertainty about the tax structure in ways that would not be helpful in terms of the continuity of the tax structure and private planning. This section does have the advantage of reducing somewhat the potential problem of relying on "biased" revenue estimates. However, that problem can be approached more directly, as it is to some extent today with "competing" estimates by an Administration and by a non-partisan Congressional Budget Office.

Section 4, which pertains to federal-state fiscal relations, on the one hand, seems to provide a needed safeguard against the "exploitation" of state budgets for federal purposes, but, on the other hand, would seem to pose some potential hazards to the formulation of new state-federal programs that might, on their merits, be sensible. I gather that this section has so far received less scrutiny than others, and I urge you to give it careful consideration.

In summary, I recognize and applaud the serious efforts that both the House and Senate are directing to the important issue of how to establish firmer fiscal discipline. I would agree that the record of the federal budget for quite a few past years, and the critical federal deficit prospects for the future, suggest that we should no longer dismiss out of hand a Constitutional approach. But I would continue to approach the question of a Constitutional Amendment with great caution; the Constitution cannot, and should not, be changed lightly to meet considerations or situations that are transient in nature, nor to "lock in" a particular economic doctrine. I am not personally satisfied that the proposal, as it stands, is fully workable. Nor do I believe that the matter of a Constitutional Amendment -- given the years that must elapse before it became effective -- is nearly as urgent as resolving constructively the current budgetary impasse.

In a sense, the current budget debate seems to me to provide an acid test of the will of the Congress -- and of the Nation -- with regard to budgetary responsibility. A vote for a future amendment seems to me not nearly so meaningful as action now -- and cannot substitute for it. If we fail that challenge, the case for a Constitutional Amendment seems to me vastly strengthened. But, for the moment, I would rather see us meet the budgetary test directly.