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FRBSF Weekly Letter

1787 Revisited

The U.S. Constitution can be amended in one of two ways. First, there is the convention approach—used only once to write the original document in 1787. Second, there is the Congressional approach, which requires a vote of two-thirds of both houses of Congress, plus ratification by three-quarters of the 50 states.

Troubled by the series of massive budget deficits of the past decade, 31 state legislatures have applied for a constitutional convention to take up a balanced-budget amendment. But meanwhile, troubled by fears of a runaway convention, both houses of Congress have begun consideration of a Congressional solution to the problem. This article reviews the differing approaches followed by state legislatures and Congressional committees, and summarizes the Congressional attempts to defuse the issue by curbing the size of the Federal deficit.

State actions

According to Article V of the U.S. Constitution, Congress would have to call a constitutional convention when so petitioned by two-thirds of the states. Partly in response to heavy lobbying by such groups as the National Tax Limitation Committee and the National Taxpayers Union, 22 state legislatures passed convention-endorsing resolutions in 1978, while eight more took similar action in 1979 and one (Alaska) in 1982. Such a budget-balancing amendment (which would be the 22nd Amendment) needs three more states to trigger Congressional action. Supporters believe that a bandwagon effect would lead such states as Missouri and Kentucky to join the parade also. They were recently disappointed, however, when the Washington State legislature failed to join the bandwagon. In that case, the State Senate called on the U.S. Congress to propose a constitutional amendment but refused to endorse a House-passed resolution calling for a convention.

Opponents of the budget-balancing approach fear that any such convention could spawn all sorts of special-interest crusades—they doubt whether the convention could be legally restricted to addressing only one issue. These opponents feel that the momentum behind the drive may have peaked, partly in response to growing concern over the impact on state finances of the Administration's proposed New Federalism. The near success of the state-based drive, however, has led Congressional leaders to take action at their own level.

Congressional actions

The Senate Judiciary Committee approved Senate Joint Resolution 58 in May 1981. If passed by two-thirds of both the House and Senate, and ratified by three-fourths of the states, that resolution would enforce a balanced budget. This Senate proposal would force Congress to adopt, prior to each fiscal year, a statement of receipts and outlays for that year. Outlays ("except those for repayment of debt principal") could not exceed receipts ("except those derived from borrowing"). Also, receipts could not rise faster than the previous year's national-income increase without approval of a majority of both houses and the President's signature. Moreover, Congress could not require that the states engage in "additional activities" without compensation equal to the additional costs. Congress could waive the provision for balanced receipts and outlays for any year in which a declaration of war was in effect, and it could authorize a specific deficit upon the vote of three-fifths of the *entire membership* of both houses.

Congressman Barber Conable (R., N.Y.) introduced House Joint Resolution 350 into the House Ways and Means Committee last October, with 84 co-sponsors. The House Bill generally paralleled S.J. 58 in its provisions. Like the latter, it would require the affirmative vote of two-thirds of the members of both houses, and subsequent ratification by three-fourths of the states. Under both resolutions, a constitutional amendment would mandate a balanced budget and tax increases that rise only with national income.

Action in the Republican-controlled Senate may be more likely than in the Democratic-controlled House. House Judiciary Chairman Peter Rodino (D., N.J.), for example, argues that the diversity among the various state resolutions regarding a convention call raises a serious question of consistent and standard format and content. Also, opponents question whether the activities of the "off-budget" agencies would be covered by the various resolutions.

Fed comments
In response to a request from Chairman Rodino last year for Federal Reserve views on the budget-balancing proposal, Fed Chairman Volcker argued that "movement towards a balanced budget is necessary if inflation is to be brought under control without undue strains on financial markets." However, he expressed the hope "That rigid—and perhaps unsustainable—budgetary rules can be avoided." Thus, he recommended that Congress first try to tighten up the budgetary process through amending and strengthening the Budget Act rather than the Constitution itself.

Volcker argued that the automatic stabilizer (i.e., anti-cyclical) features of the budget could be impaired by a budget-balancing amendment. For example, the relatively greater drop in revenues that would accompany a cyclical drop in GNP—due to the progressive nature of the Federal tax structure—could necessitate pro-cyclical cutbacks in expenditures such as unemployment compensation. His statement would suggest that both anti-cyclical tax cuts and expenditure increases could be ruled out in such a context under a balanced-budget regime.

Further, he argued that removing the automatic-stabilizer influences from the budget "would naturally place a greater burden on the use of monetary policy for stabilization purposes during recessionary periods." In contrast, supporters of a balanced-budget amendment argue that it would ease the task of monetary policy during periods of inflation and pressure on credit markets.

Volcker also argued that Congress might be tempted to circumvent budget restrictions under such an amendment by placing more activities "off-budget", and by creating more Federal loan-guaranteed programs. He also noted the technical problems created by the fact that appropriations are not identical to actual "outlays" in their timing and effects. A balanced-budget constraint conceivably could complicate the present multi-year contracting and appropriation process involved in such long-term programs as defense procurement and housing. Also, a constraint limiting outlays to receipts within a given fiscal year fails to recognize that "the rate at which actual outlays occur from budget authority cannot be forecast with absolute accuracy."

Present actions
While looking nervously over their shoulders at the constitutional-amendment threat, Congress and the Administration are now trying to control the triple-digit deficits facing them over the next several years. The Administration in its early 1982 forecast saw an aggregate deficit of $365 billion over the fiscal 1983-87 period, while the Congressional Budget Office claims that the total could reach $1,035 billion under current tax and spending legislation.

The budget committees of Congress are now thumbing through the annual report of the Congressional Budget Office, *Reducing the Federal Deficit*, in search of ways to bring receipts closer in line with projected spending. In its 1982 report, the CBO lists 69 "budget reduction options" plus 40 "options to increase tax revenues." The CBO "options" cover the entire gamut of governmental activities, but nine major proposals are worth mention.

In the defense area, the CBO lists several possibilities of spending cutbacks—such as "leapfrogging" the B1 bomber, because of the argument that the weapon could be obsolete by the time it comes on-line. That and other defense cutbacks could lead to savings of $44 billion over the 1983-87 period. In the non-defense area, the CBO says that reducing the escalator for social-security beneficiaries to two-thirds of the increase in the consumer-price index could save $76 billion over the next half-decade. It also lists a possible increase in revenue of $31 billion over that period from limiting home-mortgage deductions to $5,000 annually, as well as $35 billion in revenue from ending the deductibility of consumer-interest payments, and $27 billion from ending the deductibility of sales-tax payments.

In the taxation area, the CBO argues that $177 billion could be gained over the 1983-87 period by terminating the scheduled 1983 tax cut. Also, it notes a possible gain of $93 billion from ending the scheduled indexing of tax payments in 1985, plus another $64 billion from doubling present excise-tax rates on such products as gasoline, liquor and cigarettes.

Congressional and Administration leaders are now analyzing these and other options in an attempt to bring outlays and revenues closer together over the next several years. Obviously, they recognize that if they cannot restore fiscal discipline in this fashion, the state legislatures will try to do the job in their place, with consequences that may be both destabilizing and unpleasant.

Verle Johnston

MONETARY POLICY OBJECTIVES

Federal Reserve Chairman Paul Volcker presented a report on "Monetary Policy Objectives for 1982" at the February 10-11 meetings of the House and Senate Banking Committees. The report includes a summary of the Federal Reserve's monetary-policy plans for 1982, along with a review of economic and financial developments in 1981. Single or multiple copies of the report can be obtained upon request from the Public Information Section, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco CA 94120. Phone (415) 544-2184.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 3/10/82	Change from 3/3/82	Change from year ago Dollar	Change from year ago Percent
Loans (gross, adjusted) and investments*	159,033	1,747	12,441	8.5
Loans (gross, adjusted) — total #	137,958	1,790	13,903	11.2
Commercial and industrial	41,882	− 86	5,639	15.6
Real estate	56,423	33	5,143	10.0
Loans to individuals	23,390	− 60	− 68	− 0.3
Securities loans	2,296	114	836	57.3
U.S. Treasury securities*	6,171	− 57	− 658	− 9.6
Other securities*	14,904	14	− 783	− 5.0
Demand deposits — total#	39,058	−1,146	− 2,414	− 5.8
Demand deposits — adjusted	27,464	1,075	− 2,359	− 7.9
Savings deposits — total	30,674	− 3	722	2.4
Time deposits — total#	91,944	− 82	14,811	19.2
Individuals, part. & corp.	82,093	− 127	14,079	20.7
(Large negotiable CD's)	35,619	− 275	5,852	19.7

Weekly Averages of Daily Figures	Week ended 3/10/82	Week ended 3/3/82	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves (+)/Deficiency (−)	63	100	48
Borrowings	102	14	38
Net free reserves (+)/Net borrowed(−)	− 40	86	10

* Excludes trading account securities.
# Includes items not shown separately.

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