
THE BALANCED BUDGET AMENDMENT

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

PART I

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THE BALANCED BUDGET AMENDMENT

Friday, January 20, 1995

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
WASHINGTON, D.C.

The Committee met, pursuant to notice, at 10:00 a.m., Dirksen Senate Office Building, Room 106, the Honorable Connie Mack, Chairman of the Committee, presiding.

Present: Senators Mack, Bennett, Grams, Roth, Bingaman and Robb, and Representatives Saxton, Manzullo, Thornberry, Sanford, Quinn, Ewing, and Stark (members of the Committee).

OPENING STATEMENT OF SENATOR CONNIE MACK, CHAIRMAN

Senator Mack. Good morning, everyone.

I'd like to bring the meeting to order, and at an appropriate moment a little later on, I will welcome my colleagues on the Democratic side of the aisle that are on the panel.

I want to welcome the new members of this Committee. We will have an opportunity for some opening statements. And I will ask all of you, if you will, to keep those brief. We have a full agenda this morning. And as to why these televisions are here, we are going to have what I think will be the first interactive satellite hook-up with a witness, Dr. Milton Friedman, who was unable to fly to Washington. We were able to arrange, again, interactive satellite hook-up.

At this point, I would ask the Vice Chairman to introduce the new members of the Committee.

Representative Saxton. Mr. Chairman, we have a full slate of new members from the House side. In order of their appearance this morning, immediately to my left, Congressman Don Manzullo from the 16th district of Illinois. Don is currently serving his second term and is a member of the Small Business Committee, in addition to his responsibilities here, where he is Chairman of the Committee's Subcommittee on Procurement, Export and Business Opportunities.

So, Don, we welcome you. Don has been very active with regard to matters that have an effect on the economy on the House side and we're very, very pleased that he is able to join us on the Committee.

Also here with us is Mac Thornberry. Mac has an interesting history. He serves as the Representative of the 13th District from Texas. He also serves

on the House side on the National Security Committee with me, as well as on the Resources Committee with me.

So we're batting 1000. We're three for three together.

Interestingly, Mac served as President Bush's Deputy Assistant Secretary for Legislative Affairs, and so, he is no stranger to those of us here on the Hill.

To join us in a few minutes will be Mark Sanford from Charleston, South Carolina. We look forward to his arrival, as well as Jack Quinn from New York's 30th District, and Tom Ewing from Illinois's 15th District.

Senator Mack. On the Senate Republican side, Senator Rod Grams is joining us. We're delighted to have you with us. Unfortunately, I do not have a background sheet on you. We're just delighted that you're here.

I will turn to Congressman Pete Stark and say how delighted I am to have the opportunity to work with you on this Committee, to welcome you and look forward to the next couple of years.

Representative Stark. Thank you, Senator.

Senator Mack. I think at this point we'll start with the opening statements. And again, I would ask the members to try to hold their statements down. We do have a rather ambitious schedule to try to keep and I would appreciate that.

We're in a unique position today. We have an opportunity to guarantee to the American people that from now on, government spending will be limited only to what it can afford.

I believe that passage of the Balanced Budget Amendment, with the inclusion of a tax limitation provision, will create stronger growth, higher living standards, and a more competitive economy that will carry us into the 21st Century.

Milton Friedman, who will be testifying later today before this Committee through an interactive satellite feed, is passionate and eloquent on the importance of a balanced budget amendment. According to Dr. Friedman, and I'm quoting now, "It cannot be emphasized too much that the real burden on the economy is what government spends, rather than how much it receives in taxes."

Consider these facts.

From 1947 to 1994, total Federal spending expanded on average 10.1 percent a year, excluding defense and interest on the nation's debt, while nominal GDP grew only at a rate of 8.1 percent. If government spending consistently grows two percentage points faster than the economy, the government would double in size relative to the private sector every 35

years. In other words, the Federal Government, which now consumes roughly 23 percent of GDP, would consume 46 percent of GDP by the year 2030.

To ensure real budget constraint, I believe that it is profoundly important that we include a tax limitation provision to the Balanced Budget Amendment. The spirit of the American people has been weighted down with higher taxes and higher spending. It has to stop. The American people want spending cuts, not tax increases. A tax limitation provision makes the good idea of a balanced budget amendment even better. The danger of a balanced budget amendment without a tax limitation provision is that the amendment could become a tax collection machine instead of a real constraint on Federal spending. As Dr. Friedman points out, and again I quote: "There is nothing to prevent balance to be achieved by a massive tax increase and nothing to prevent further increases in government spending as long as they are accomplished by higher taxes."

Later in this session of the Congress, this Committee will direct its attention to my proposal for a Government Spending Reduction Commission styled after the Base Closure Commission. If Congress fails to discipline itself with spending cuts after enactment of the Balanced Budget Amendment, the Government Spending Reduction Commission would provide Congress with a way to responsibly achieve our objective of a balanced budget.

Our Founding Fathers knew that restraining government growth was essential to the well-being of our economy. Looking to the future, we must ensure for our children's children that restraint and responsibility will be the watchwords of our fiscal affairs. The spirit of innovation and ingenuity in the American economy must be revived.

A balanced budget amendment is more than a legal issue. What it really represents is less taxing, less spending, less government, and more freedom for the American people.

Now I will turn to Congressman Stark for his opening statement.

**OPENING STATEMENT OF REPRESENTATIVE PETE STARK,
RANKING MINORITY MEMBER**

Representative Stark. Thank you, Senator. And I just could not agree with most of your statement more.

I want to begin by commending you for holding these hearings. We can talk about broad outlines of sensible economic policies and, as we are doing today, deal with some economic policies that are not so sensible.

Last week, Al Hunt had a piece in *The Wall Street Journal* on the balanced budget and pointed out our inconsistencies when we tout the Contract With America as giving the American people a detailed agenda. But we won't give the American people any details about how we intend to balance the budget.

I am sure that all of us here on the dias would like to reduce government spending, certainly reduce taxes, and make the country more secure.

But I have, in a somewhat lighter vein, offered several thousand dollars. And I'll renew that today. I offered a \$1,000 contribution to charity to any Republican member, and it's now \$2,000, who can tell us in detail how they'd balance the budget in Fiscal '96, at the same time increasing defense and cutting taxes.

Well, the challenge is out there. We'll use last year's CBO figures. But if you want to go consistently with some other responsible estimate, I would.

Secondly, the idea doesn't make any sense, a balanced budget amendment. The idea of reduced spending makes a lot of sense and the idea of less taxes makes a lot of sense. But there isn't a family or a corporation in America that could live with this Balanced Budget Amendment.

Everybody says, we live that way. That's nonsense. There's nobody in this room -- the only person I know in Congress that ever bought a house and paid cash is Bill Archer.

It's true.

(Laughter.)

The American people have \$300 trillion of FHA debt and everyone of them who fulfilled the American dream of owning a home spent more in that year than they took in.

And are we complaining? No. We're passing laws to help them, to encourage them. A few years ago, seven of the top 250 corporations paid no tax. That means, technically, they had no earnings.

Is that bad? No. Every biotech start-up in the country loses money for the first five years. That means they spend more than they take in.

Do we complain about that? No.

What we are setting up in this Amendment is an accounting gimmick. The minute we could go to a capital budget and spread our Federal purchases out over six years, and this Amendment doesn't say anything about it and you'd have the longest court case, then we'd balance the budget and still spend more.

So, if we want to be realistic, we have to face the problem that only we collectively can solve in both sides of this Capitol, and that's to spend less.

And a balanced budget amendment is going to do nothing but confuse the courts and confuse us and, worst of all, confuse the public, who's already pretty confused about what we're doing.

Thank you.

[The prepared statement of Representative Stark appears in the Submissions for the Record.]

Senator Mack. Congressman Saxton?

**OPENING STATEMENT OF REPRESENTATIVE JIM SAXTON,
VICE CHAIRMAN**

Representative Saxton. Thank you, Mr. Chairman.

Mr. Chairman, it was 10 years ago that I came to the House of Representatives. You were in the House at the time and we got to be good friends. Joe Barton, who is here to testify, was fortunate to come at about the same time. It was 40 years ago that people came to the Congress and took over, who talked like the previous gentleman about how unnecessary it is to balance the budget, at least with a balanced budget amendment.

But in spite of the partisan tone of the previous speaker, I still look forward to working with him to try to get spending under control. And it was 10 years ago, the first thing I did when I arrived here as a freshman was to put together my version of a balanced budget amendment. And frankly, it was very much like the one that Dan Schaefer, Congressman Schaefer from Colorado, and Mr. Stenholm from Texas, have introduced and are now pushing and is very much part of this debate.

But during that 10 years, I've recognized that while we need a provision to provide for a balanced budget, that it also needs to have some language in it that would show us how to implement it.

That's why a couple of years ago, I joined forces with Congressman Joe Barton and, at the time, Congressman Kyl, to provide for some language in the Constitutional amendment which we now refer to as the tax limitation language, which I think is an essential part of this process and an essential part of what we ought to see as part of a balanced budget amendment.

I'm here today to hear testimony, I'm sure on both sides, from some who favor and from some who do not.

Now I'm convinced that, being part of the vote-counting mechanism on the House side, that we're going to have most Republicans who are going to vote in favor of a balanced budget amendment next week, which includes tax limitation language. That means having a vote of at least 60 percent of the membership in either House in order to put in place increased taxes to balance the budget.

Now in spite of the fact that we're making every effort to get to a point where we get 290 members, both Republicans and Democrats, to vote for that provision, there is some chance that it may fail. And if it does, we'll go on with other provisions.

Today, I'm introducing a substitute on the House side just for purposes of discussion which provides for a limitation on spending, which is a little different approach, but I think gets us to the same point ultimately.

Congressman Solomon, who is the Chairman of the Rules Committee, has agreed to entertain the idea, should the occasion arise that we are unsuccessful with the approaches that have been outlined so far.

So whether we limit taxes through a Constitutional provision, or whether we put a limitation on spending, certainly, something needs to be done to change the rules of how we do business with regard to taxes and spending.

And so, Mr. Chairman, I thank you for holding this hearing today. I think it's absolutely imperative that we talk with each other about these issues and with the American people.

I thank you very much.

Senator Mack. Senator Bingaman?

OPENING STATEMENT OF SENATOR JEFF BINGAMAN

Senator Bingaman. Thank you very much, Mr. Chairman.

Let me say that I'm particularly interested in hearing what the witnesses have to say on this tax limitation provision, which you referred to in your opening statement and several of the other folks have already referred to.

In the time that I've been here in the Congress, I have supported a balanced budget amendment. I've supported what I thought were most of the -- in fact, I believe all -- of the serious proposals for deficit reduction, the various packages when President Bush was in office, the one two years ago that President Clinton proposed, in each case that I'm aware of where we have made serious progress on reducing the projected deficit. We have made some progress. We are now in the third year of deficit reduction, and I think that's progress.

But in each case, it has been done through a combination of spending cuts and revenue increases. This year, we have a new sort of paradigm shift, as I see it, with this tax limitation provision where we're saying that we're going to make it much more difficult to raise any additional revenue. We're going to continue to have the goal of a balanced budget. We're going to continue to reduce the deficit, but we're no longer going to do that or more toward that by looking both at spending cuts and at revenue increases.

I'm just interested in hearing testimony as to how we get it all done on the spending side because, realistically, that is very tough. And as I say, whether it's been Democratic presidents or Republican presidents in the time I've been here in Washington, the real progress that's been made in deficit reduction has been with a combination of the two.

It seems to me that general consensus that we had to do both seems to have been eliminated in the present discussion and I'm interested in getting people's explanation as to how we do it all on the spending side.

Thank you very much.

Senator Mack. Thank you. I wonder if I might ask the other members to hold their opening statements. We have three of our colleagues here have schedules that they have to meet.

What I'd like to do is go ahead and let them make their presentations, let them go, and then we can get back to the opening statements.

At this point, I want to welcome all three of you. We look forward to your input and Senator Kyl, why don't you start?

PANEL I

STATEMENT OF THE HONORABLE JON KYL, SENATOR FROM ARIZONA

Senator Kyl. Thank you very much, Mr. Chairman. I compliment you for holding this hearing. I look forward to visiting with my old House colleagues and in engaging in this debate as time goes on.

But rather than carry on the debate that has begun by the opening statements this morning, let me provide you with my statement that reflects my particular view on why a spending limitation approach is the preferable approach to this problem.

I appreciate the opportunity to appear before the Committee today and to discuss specifically whether or not to include a explicit limitation in the Amendment on taxes or spending.

Mr. Chairman, a balanced budget should, in my view, accomplish two things. First, it should promote fiscal responsibility and second, and perhaps equally important, it should promote policies that foster economic growth and opportunity.

A balanced budget amendment, without a spending or tax limitation, would force Congress to be more responsible in its budgeting practices. But there is more to responsible budgeting than *just* balancing the nation's books. It also matters at what level Congress balances its books relative to the size of the nation's economy. The gross national product now exceeds

\$6 trillion. But as economist Walter Williams pointed out in a column last year, few would be happy if Federal expenditures were \$6 trillion and Federal tax revenues were \$6 trillion. It would be in balance, but it would be an awful state of affairs.

So it matters at what level we balance the budget.

Gerald Scully, a senior fellow of the National Center for Public Policy Analysis and a professor of economics in the School of Management at the University of Texas at Dallas, came to a similar conclusion in a report published last November.

Here's what he found.

"American productivity has faltered since the 1950s. Productivity growth rates that were in the 3.1 to 3.5 percent range have fallen below 1 percent. As a result, many Americans have suffered a decline in their living standard. Considerable evidence points to the growth in the size of government since World War II and the accompanying increase in taxes as a cause."

Scully went on to suggest, and I'm quoting here, that in order to maximize economic growth, the average rate for Federal, state and local taxes combined should be between 21.5 percent and 22.9 percent of the gross national product. Taxes as a share of GNP have not been in this range since 1949.

There are two ways to get to that optimum level of government that Scully discussed -- limit taxes or limit spending. Or both. And I support either approach. But I believe that a spending limit is preferable. It represents the most direct approach and the easiest to implement.

And I believe my staff has circulated to you a *Washington Times* editorial of sometime last week that refers to Mr. Saxton's approach and also refers to my spending limitation approach as very simple and straightforward.

Limit taxes, I suggest, and the only way to balance the budget is to cut Federal spending. Why not say so at the outset -- limit spending and there's no need for Congress to consider tax increases. It wouldn't be allowed to spend the additional revenue.

Mr. Chairman, 19 states across the country have some form of spending limits, either in statute or in their constitution. And a Federal spending limit is at the core of the Balanced Budget Spending Limit Amendment. S. J. Res. 3, which I introduced on January 4th.

My Amendment would require a balanced budget and limit spending to 19 percent of the gross national product, which is roughly the level of revenue that the Federal Government has collected for the last 40 years. By limiting spending, my Amendment ensures that the budget will be balanced

the way the American people want -- by cutting spending. And by linking spending to GNP, it provides Congress with a positive incentive to promote pro-growth economic policies, because only a growing economy measured by the GNP would increase the dollar amounts that Congress could spend.

Whether or not Congress writes a Federal spending limit, or a tax limit, into a balanced budget amendment, or subsequent implementing legislation, I would assert that Congress will have to deal with the effective limit on revenues relative to GNP, which the economy itself has imposed.

As I noted earlier, revenues to the Treasury have fluctuated around a relatively narrow band of 18 to 20 percent of GNP for the last 40 years. That is despite tax rate increases and tax cuts, good economic times and bad, and fiscal policies pursued by presidents of both political parties.

That is because changes in the Tax Code changes people's behavior. Lower taxes stimulate the economy, resulting in more taxable income and transactions and more revenue to the Treasury. Higher taxes discourage work, production, savings and investment. So the economy grows at a slower rate and revenues are always less than initially projected.

Although tax cuts and tax rate increases may create temporary declines in surges in revenue, revenues always adjust at roughly the same percent of GNP as people adjust their behavior to the new tax code.

Since revenues remain relatively constant, at about 19 percent of GNP, the significance of our nation's tax policy is whether it leads to a stronger and larger economy, measured in terms of GNP, or a weaker and smaller economy.

In other words, 19 percent of a larger GNP would represent more revenue to the Treasury than 19 percent of a smaller GNP.

I'll conclude in just a moment, Mr. Chairman.

The 1986 Nobel Laureate in economic sciences, Dr. James Buchanan, put it this way -- reducing government as a share of GNP from its 1991 level of 25 percent to, say, 20 percent, would generate roughly a 2 percent increase in the rate of growth of the GNP. And back-of-the-envelope arithmetic suggests that by the early 2000s and forever beyond, the real value of the programs financed by government would be larger than they would be under the regime that keeps government's share at 25 percent.

So, in conclusion, Mr. Chairman, limit spending to the level relative to GNP that the economy has historically been willing to bear, and the incentive will be for Congress to enact pro-growth economic policies.

Limit spending and there's no need to raise taxes. Limit spending and the real cause of big deficits is resolved.

I believe a constitutional amendment to require a balanced budget should include a Federal spending limit. But I also suggest that the stakes are too high in terms of the mountain of debt we're passing on to future generations to miss yet another opportunity to send the basic version of the Amendment to the states for ratification.

If the votes are not there for a spending or tax limitation amendment, then I believe Congress should adopt the basic amendment.

We can deal with the issue of spending limits or tax limits in the context of implementing legislation and, indeed, I believe we will.

I certainly look forward to working with the members of the Committee and others in that regard, and thank you for the opportunity to make this presentation this morning.

Senator Mack. I thank you, Senator.

Senator Kyl. And Mr. Chairman, if I could be excused, I have a conflict. I apologize.

[The prepared statement of Senator Kyl appears in the Submissions for the Record.]

Senator Mack. Absolutely.

Congressman Barton, welcome.

STATEMENT OF THE HONORABLE JOE BARTON, REPRESENTATIVE FROM TEXAS

Representative Barton. Thank you, Mr. Chairman, and other members of the Joint Economic Committee.

I have a formal statement I'm going to submit for the record. Apparently, you want us to do our testimony in about five minutes, so I'm going to paraphrase that.

I can almost say I'll just take your opening statement and use it as mine. But in the interest of diversity, I'll give my statement.

Next week, the House of Representatives has an historic opportunity to pass a tax limitation balanced budget amendment. As this Congress has begun, our national debt is \$4.8 trillion. That's about \$18,300 for every man, woman and child in this country.

The payment of interest on this debt is a drain on our economy. It keeps interest rates higher than they would be otherwise. It makes it more difficult for families to finance private-sector investments. It's a general drain on the economy.

We have amassed this immense and increasing, ever increasing debt, by consistently overspending. Congress, which has the power to balance the budget has not done so since 1969. It's only done so five times in my lifetime, and I was born in 1949.

Since I have come to Congress in 1984, with Congressman Saxton, I have each year introduced a Tax Limitation Balanced Budget Amendment. The opinion polls show that the American people strongly support balanced budget amendments generically and when told about the tax limitation provision, the support goes up.

Yesterday, Senator Grams introduced at a press conference, that he and Senator Gramm of Texas held, a new poll by the American Conservative Union that showed that of those people that support balanced budget amendments, over two-thirds of them support balanced budget amendments with tax limitation.

The Amendment is rather simple. It requires the President to propose, and the Congress to submit, a balanced Federal budget. It erects tough barriers to prevent him from doing otherwise. It requires a 60 percent or three-fifths vote to deficit spend, a 60 percent, three-fifths vote, to raise taxes, and a 60 percent, three-fifths vote to increase the national debt ceiling.

The tax limitation provision is an important part of the Balanced Budget Amendment because it raises the percentage required to raise taxes, thus making it more probable that spending will be reduced in order to balance the budget.

Four of the last five major tax increases have not passed the Congress by the 60 percent vote required in the Tax Limitation Balanced Budget Amendment. If those tax increases had not passed, the tax burden would be \$666 billion less on the American people.

There is growing support in the states for tax limitation. Nine states already require at least a three-fifths vote for tax increases -- Arizona, Arkansas, California, Delaware, Florida, Louisiana, Mississippi, Oklahoma, and South Dakota. And in November of last year, 78 percent of the Nevada voters gave the first of two approvals necessary to put a two-thirds requirement for tax increase into their state constitution.

The experience in states that already have tax limitation show that it works. From 1980 to 1987, taxpayers in states with tax limitation provisions enjoyed a 2 percent decrease in their portion of personal income that they paid in state taxes. At the same time, in states that did not have tax limitation provisions in their constitution, taxpayers experienced an increase of 2 percent in their tax burden.

That's a 4 percent difference.

In fact, in almost every year since 1980, taxes have increased more in those states without super-majority requirements for tax increases than in those states that had them.

Tax limitation also curbed spending. The ratio of spending to personal income increased approximately 9 percent in states that did not have a tax limitation provision in their constitution, but it only increased 2 percent in the states that did.

That's a 7 percent differential.

Support for Tax Limitation Balanced Budget Amendment continues to grow in the House of Representatives. Last year, for the first time, we received a majority vote on tax limitation in the House, while the non-Tax Limitation Balanced Budget Amendment lost votes from the year before.

And two weeks ago in the House of Representatives, in our rules package, we passed with 279 members a requirement that there be a three-fifths vote to raise income taxes in this Congress.

Mr. Chairman, I have a list of organizations that are supporting tax limitation. I'll submit that for the record.

Suffice it to say that we are absolutely serious in the House to pass a tax limitation Balanced budget amendment with the requisite 290 votes, send it to our eminent body on the Senate side, and with the leadership of Senator Grams and, hopefully, Senator Mack and others on the dias, we'll pass tax limitation in the Senate and send it to the states for ratification.

[The prepared statement of Representative Barton and accompanying list of "Organizations Supporting the Tax Limitation Balanced Budget Amendment" appear in the Submissions for the Record.]

Senator Mack. Thank you, Congressman Barton.

Congressman McDermott, welcome, and we're prepared to hear your testimony.

**STATEMENT OF THE HONORABLE JIM McDERMOTT,
REPRESENTATIVE FROM WASHINGTON**

Representative McDermott. Thank you, Mr. Chairman.

My remarks are a little bit more than five minutes. I hope you'll indulge me a little.

It's like the day in Texas when there was a riot and they called for the Texas Rangers. One ranger showed up. The question was where are the rest? He said, one riot, one ranger.

So I'm the ranger from the other side.

(Laughter.)

Senator Mack. Well, welcome to the riot.

(Laughter.)

Representative Barton. But he's not from Texas.

(Laughter.)

Representative McDermott. I'm here really to add my voice to a number of people who are opposing the Balanced Budget Amendment. In fact, this Balanced Budget Amendment is nothing more than a hidden tax on the American people.

Mandating a zero deficit by the seventh year after the Amendment is sent to the states for ratification will simply shift a tax equal to the cost of many programs which currently receive Federal monies onto the states. State governments will face the difficult choice of either raising taxes in order to continue to provide the same level of service or cutting popular and needed programs.

Ironically, this Balanced Budget Amendment will prove to be the biggest unfunded mandate ever passed by the Congress.

On the one hand, the Republican Contract With America eliminates unfunded mandates and with the other hand, it silently imposes on local and state governments a horrific and inevitable tax burden.

The Congressional Budget Office and others estimate that Congress will have to cut \$1.2 trillion, and it would be \$1.6 trillion if the tax reductions in the contract area also enacted, and this all happens by the year 2002.

This will require the Congress to make \$843 billion in unspecified program cuts, with the rest of the savings attained by debt service savings and a freeze on discretionary spending, which will amount to an additional \$193 billion in cuts.

It is the \$843 billion minimum unspecified cuts and the freeze on discretionary spending that will produce a fiscal nightmare that states, local governments and individuals will have to bear.

A *New York Times*-CBS poll conducted last month found that 81 percent of the voters supported a balanced budget. That's why it's in the Contract With America. Support for the Amendment, however, dropped to 41 percent if it meant raising Federal income taxes, down to 30 percent if social security payments were cut, and to 27 percent if Medicare benefits were reduced.

Yet, increased state taxes and cuts in Medicare and Medicaid to the tune of \$300 billion are going to occur if a balanced budget amendment is passed.

Washington State, where I come from, currently receives 21 percent of the total state budget from the Federal Government. A study released last week by the Treasury estimates that the State of Washington will have to raise taxes by 8.4 percent in order to maintain the same level of service if the Balanced Budget Amendment is adopted.

Inclusion of the Republican contract tax cuts in the Balanced Budget Amendment would require an increase of 11.5 percent.

Washington State fares a lot better than a lot of other places in this country. Georgia will have to raise its taxes by a minimum of 12 percent, Mississippi by 20.8 percent, South Dakota by 24.7, and Louisiana by about something over 30 percent.

I don't think there's any governor, representative or senator in this room who wants to explain to their constituents why the Balanced Budget Amendment has resulted in increased taxes at the state level.

Unfortunately, explaining this unfunded mandate in the form of a tax shift is inevitable.

The reason I came to testify is that in 1981, when President Reagan increased defense spending, cut taxes, and drastically increased the Federal deficit at the expense of community support, I was the Chairman of the State Senate Ways and Means Committee. As a former member of a state legislature, I'm here to tell you when Federal spending is reduced, the burden falls directly and immediately on the states to repair the damage.

Just take the school lunch program.

I think all elected officials, regardless of party, will agree that it's important that children of school age be able to have a hot, nutritious meal at lunchtime. Washington State received \$80 million in Fiscal '94 from the Federal Government. Six million of that goes directly to the Seattle program.

When Federal funding for the program is reduced, which is inevitable if the Balanced Budget Amendment is passed, it will fall upon the state and local government to either provide the money by raising taxes or stop feeding kids.

Now if the money is not provided, our Medicaid bill will probably go up to treat the significant increases in childhood anemia and malnutrition, the incidence of which have dropped dramatically in this country since the implementation of Federal nutrition programs.

I could talk about transportation, but I want to move to education.

Enactment of the Contract will result in a decrease in the funding to the University of Washington by \$470 million over seven years, directly translating into higher tuition payments for students.

When Warren Magnuson was in the United States Senate, he set up a program called WAMI -- Washington, Alaska, Montana and Idaho. The University of Washington medical school serves as the medical school for Montana, Idaho and Alaska, as well as Washington.

All of these states will have to contribute more for their residents' access to medical schools. This will be intensified by the accompanying reductions in Medicare support for graduate medical education.

I'm currently in the process of putting together an evaluation of the impact of the budget cuts on my state and my county. When I'm finished, I plan to use that data to illustrate to my constituents in dollar amounts they can identify with how passage of the Contract With America will negatively affect the quality of life of the residents of my district as a result of decreased government service combined with increased state and local taxes.

The list of potential draconian budget cuts is endless. As funding of all types is slashed, jobs will be lost in transportation, education, health care and agriculture.

Remember, the food stamp program is not just money thrown out the window. It directly and indirectly supports commodity sales in this country.

The ripple effect through the economy will be profound. What's worse -- the safety net that traditionally supports Americans through periods of economic transition will be gone. These are not big government programs. These are not programs not providing laptops for inner-city kids, but programs which provide the basic necessities of life and programs that keep our communities running.

We all want to see budget discipline. I lived under a balanced budget in the state legislature. I'm proud to say that I've actually voted for budget discipline in this Congress. The other gentleman here voted against it when it was in the House.

But this Balanced Budget Amendment which satisfies the political rhetoric at the cost of economic policy, in my opinion, is irresponsible.

The American people are entitled to a gradual and economically stable reduction of the deficit. The American people do not deserve the chaos that a balanced budget amendment would bring on them. I think you will pass this thing now and in six years, you won't be here when it hits. But I don't think term limits is going to work and I think we're all going to be here and you ought to think very carefully about passing a balanced budget amendment that creates this kind of chaos.

Thank you, Mr. Chairman.

Senator Mack. Thank you.

Again, for the purposes of the time, I assume that you all have schedules to meet, so we are going to proceed along with our meeting.

Thank you very much.

Representative McDermott. Thank you very much.

Representative Barton. Mr. Chairman, could I make just one -- I want to respond to something that the distinguished congressman from California said in his opening statement, with your permission.

Senator Mack. The problem with that, Joe, is you know that there will be a response back.

Representative McDermott. I'm sure I'd have something to say.

(Laughter.)

Senator Mack. So, again, because of time --

Representative Barton. All right. Thank you, Mr. Chairman.

Representative McDermott. It's a draw.

(Laughter.)

Senator Mack. Congressman Manzullo?

OPENING STATEMENT OF

REPRESENTATIVE DONALD MANZULLO

Representative Manzullo. Thank you very much.

I would like unanimous consent to submit my opening statement. I do have a 20-second -- it's very simple.

Thomas Jefferson said that we should shackle the people with the chains of the Constitution. I think, very simply, the Balanced Budget Amendment is another link in that chain. I don't want to get into any kind of a dispute with my distinguished colleague from California, but I would state that the Congress has bought a house, the payments of which it simply cannot afford, and that's how we differ from the regular homeowner.

But I'm not getting into a dispute, am I? Thank you.

[The prepared statement of Representative Manzullo appears in the Submissions for the Record.]

Senator Mack. Congressman Thornberry?

OPENING STATEMENT OF

REPRESENTATIVE MAC THORNBERRY

Representative Thornberry. Thank you, Mr. Chairman.

I certainly look forward to working with you and the other members on this Committee. I think this Committee has an opportunity to take a somewhat broader and longer view of the many changes which I hope are going to occur on both sides of the Capitol.

The key question for me is where you put your trust. Do you trust government or do you trust individuals to make people's lives better?

I put my trust in the people. I think a good place to start is a balanced budget amendment to put some discipline on the Federal Government. And I certainly support the three-fifths tax provision to make it more difficult to raise taxes on people.

I look forward to hearing from other witnesses today on the economic effects of that provision and again look forward to working with you.

Senator Mack. Thank you.

Senator Grams?

OPENING STATEMENT OF SENATOR ROD GRAMS

Senator Grams. Thank you, Mr. Chairman, and thank you for calling this very important meeting on the impact of a balanced budget amendment, which requires a super-majority to increase taxes.

I also ask unanimous consent to have my opening statement submitted to the record. I'd like to just make a few quick comments about the fact that I believe so strongly in this, that I did introduce a bill yesterday called the Taxpayer Protection Balanced Budget Amendment Act, which calls for a super-majority.

We have a history in this country of trying to balance the budget by raising taxes first and then promising to cut spending later. But what we have gotten is always the tax increases but we have never gotten the spending cuts.

And if you go back just four decades, for an average American, for every \$50 you earned, you sent one dollar to the Federal Government.

Today, it's every four dollars you earn, you send one dollar to the Federal Government. And it's going on a path that, within the next decade, it's going to be one dollar in every three.

So when we talk about taxpayers in this country paying their fair share, what does Washington believe is your fair share that they should control and dictate the spending?

And you hear a lot of opponents to this saying, well, if we're going to cut this budget, we're going to cut programs.

These dollars are going to be spent on many of these same programs and helping many of the same people, only it's going to be decided by a different group than Washington. It's either going to be decided by governors, state legislatures, by county governments or by parents and individuals.

What we're doing in this is really just taking control from Washington and passing it down to state and local governments and individuals.

So the argument that if we take these dollars out, that we're going to increase spending or we're not going to fund food and nutrition programs or immunization programs, is fallacy.

These programs will be handled. It's just at a more local basis. And that's why I strongly support this, because the biggest loser in this is going to be the Federal Government and Congress trying to dictate how you should spend your own money.

Thank you, Mr. Chairman.

[The prepared statement of Senator Grams appears in the Submissions for the Record.]

Senator Mack. Senator Craig?

OPENING STATEMENT OF SENATOR LARRY CRAIG

Senator Craig. Mr. Chairman, thank you very much for holding this hearing and getting this group of witnesses before us as we move both in the House and in the Senate to deal with this most important issue.

I am of the belief that the Congress will pass a balanced budget amendment resolution this year to send to the states. I am also of the belief that it will be the resolution that just came out of the Judiciary Committee of the Senate that has a tax limitation. That tax limitation is a constitutional majority and not the three-fifths.

But it has the three-fifths as it relates to the vote to raise debt or debt ceiling. It is a strong, disciplinary approach towards resolving this problem that all of us are aware of in one form or another. There is no question about it.

While I originally in 1982 introduced tax limitation amendments in the House and worked very strongly to get them, I also believe in the discipline that the voter has so displayed this year in choosing those who prefer tax limit in their votes instead of those that prefer tax increases. And that's the true tax limitation.

But what is interesting here this morning, when we hear from congressmen like Congressman McDermott, is that we really heard a statement in static. And by that I mean he believes that government will continue on auto-pilot and it will raise at 4 or 5 or 6 percent a year in its growth figures.

He doesn't look at interest rates coming down and productivity going up as government eats up less the chunk of the gross national product on an annual basis.

And so what we have is testimony in static, that we're going to keep a big Federal Government. We're going to keep it growing at a given rate and that's the way it's just simply going to be. And so, therefore, state governments will have to pay for 21 percent of budgets that are now funded by the Federal Government, that we're going to have \$30 billion in food stamps and accept a billion dollars in fraud.

Those are all the acceptable things of government.

We all know those are not acceptable and we are not going to accept them any longer. And we're going to see a progressive down-sizing of government, and certainly, a balanced budget amendment, in the context of the kind that we think is the bipartisan, bicameral approach, that which was voted on in the House last year and in the Senate last year, that barely missed in both bodies, will ultimately go to the people this year.

And it will be real discipline and it will work. And this Congress must respond, and I think they will.

But what you're doing this morning is critically important as we begin to build a base in this debate as we move it to the House this coming week, and possibly to the Senate next week.

And I thank you.

Senator Mack. Congressman Ewing?

OPENING STATEMENT OF REPRESENTATIVE THOMAS EWING

Representative Ewing. Thank you, Mr. Chairman, and to your Vice Chairman, both. I really appreciate the opportunity to serve on this Joint Committee and look forward to its deliberations and to being a contributing member, as well as learning a great deal here.

I would go on record as saying that I strongly support the Balanced Budget Amendment. I strongly support it in the strongest form possible with tax limitation.

I would make two additional comments that I think are very important in considering it.

Number one, there is a great deal of scare tactics used when those who oppose the balanced budget discuss it. And every bad thing is going to happen to every special interest group in America if we pass it.

And we know that's not so and we need to get beyond that.

The other point that I think is important to consider is what happens if we don't do the Balanced Budget Amendment? This Congress and the previous Congresses have proven they cannot discipline themselves in spending. We have children. We have grandchildren that will carry that tremendous burden.

We must act now. We must act in this Congress. I strongly encourage all of us to get behind the strongest Balanced Budget Amendment possible.

Thank you.

Senator Mack. Thank you.

Congressman Quinn?

OPENING STATEMENT OF REPRESENTATIVE JACK QUINN

Representative Quinn. Thank you, Mr. Chairman.

I, too, as a new member of the Committee, am pleased to be here and want to go on record with a prepared statement, if I may, and associate myself with the remarks, just briefly, of Senator Craig. I think that we will hear testimony later on in the weeks to come, and we've heard some today, where many of our members here in the House and the Senate are concerned about providing the money, for programs. That seems to automatically mean for some people raising taxes. Everybody assumes that the way to provide these services is always to raise taxes.

I think that this discipline will change the way we do business. I think that a hearing today and your leadership in this area is something that the Congress needs and, more importantly, that the people need in this country.

I'm happy to be a part of it and I look forward to working with you.

Senator Mack. We're glad to have you with us.

Senator Roth?

Senator Roth. Well, thank you, Mr. Chairman, for holding these hearings.

In the interest of bringing the witnesses before us, I waive any right to speak.

Senator Mack. Bless your heart.

(Laughter.)

If the next panel would come forward.

I understand that Dr. Chimerine is not here yet. We will proceed, and hopefully, he will be here in the next few minutes.

We have with us this morning Dr. William Niskanen. The Committee is honored to have with us, the former head of the President's Council of

Economic Advisers, where Dr. Niskanen served under President Reagan. With a BA from Harvard and a Ph.D from Chicago, he is well credentialed to give his remarks before Congress on a wide range of issues, including his specialty -- analyzing why increased government expenditures in certain sectors do not yield a proportional increase in the level and quality of their services.

As Chairman of the CATO Institute and founder of the National Tax Limitation Committee, Bill remains in the public debate and we are pleased to have you with us this morning.

Mr. Lew Uhler is readily identified with the issue before the Committee this morning. He has been a student of the Balanced Budget Amendment for a very long time. In fact, in 1972, under then-Governor Ronald Reagan, and with help from Nobel Laureates Milton Friedman and James Buchanan, he developed the Landmark Revenue Control and Tax Limitations Act, which has become the model for many such amendments around the country.

He has a BA from Yale and a law degree from Berkeley, and is the author of *Setting Limits -- Constitutional Control of Government*.

We're delighted to have you with us as well, Lew.

Doctor, if you will go ahead and present your testimony.

PANEL II

STATEMENT OF WILLIAM A. NISKANEN, CHAIRMAN, THE CATO INSTITUTE

Mr. Niskanen. Thank you, Mr. Chairman.

My brief remarks summarize the case for new fiscal rules. For the first 140 years of our history under the U.S. Constitution, the Federal budget was effectively limited by two rules -- the formal limits in the Constitution on the enumerated powers and an informal rule that the government could borrow only during recessions and wars.

At the end of the 1920s, Federal expenditures were 2.6 percent of GDP, most of which was for the military and the deferred costs of prior wars. And a characteristic budget surplus during peacetime recovery years constrained the Federal debt to 16 percent of GDP.

The constraints on Federal spending and borrowing also contributed to the conditions that led to a remarkably stable general price level over this 140-year period.

Over the past six decades, however, Federal expenditures have increased to now 23 percent of GDP, most of which is for new forms of services and transfer payments. Larger and more frequent budget deficits that have been

continuous since 1969, have increased the Federal debt held by the public to an amount about 50 percent of GDP.

The general price level is now about ten times the level at the beginning of this period. This dramatic change in fiscal and monetary conditions in my lifetime occurred without one single amendment to the Constitution that would authorize an expansion of the fiscal powers of the Federal Government.

Our effective Constitution has been transformed into one in which Congress and the President may authorize any type and amount of expenditures and taxes subject only to the voting rule for routine legislation.

The appropriate response to this erosion of the substantive limits on Federal fiscal powers is to approve more constraining voting rules on decisions affecting the budget total.

One should reject out of hand the argument that such rules are inherently inconsistent with democratic government. Our Constitution now requires a super-majority of Congress to approve several types of measures. Congress itself has established a super-majority rule for several other types of measures now, including proposals to reduce taxes.

Almost all of the states have some form of special rule on the issue of new debt. Many of the states require a super-majority of the legislature or a referendum for a major increase in taxes.

Majority rule has instrumental value in that it is the minimum voting rule that avoids inconsistent decisions on the same vote, but it does not have normative value in and of itself. Democracy is not defined by majority rule.

There is ample precedent and a strong case for requiring a higher voting rule on more important decisions like the overall levels of the public debt and on taxes.

Two remaining issues must be resolved, however, to assure approval and ratification of an effective amendment. The Senate version of the proposed Amendment which authorizes an increase in taxes by a majority of the members of each house does not provide an adequate barrier against increased taxes.

The Senate rule would increase the prospect that the budget would be balanced by higher taxes rather than by a slower growth in spending. The Senate rule would weaken the potential economic benefits of the Amendment and it substantially reduces the prospect for ratification.

A second problem is that neither version, neither the House nor the Senate version, provides state and local governments from an increase in unfunded mandates.

Congress now plans to vote on a statute that provides such protection before the vote on the proposed constitutional amendment. But statutory protection that may later be changed is not likely to be sufficient to assure ratification of the Amendment requiring a third of the approval of the legislatures of 38 States.

Congress is now rushing to vote on these issues by the end of next week. If it takes more time to resolve the above issues, I strongly encourage you to delay the vote. There has never been a better opportunity to restore a responsible fiscal constitution.

Do it right. Seize the day. Thank you.

[The prepared statement of Mr. Niskanen appears in the Submissions for the Record.]

Senator Mack. Thank you. Mr. Uhler?

**STATEMENT OF LEWIS K. UHLER, PRESIDENT
NATIONAL TAX LIMITATION COMMITTEE**

Mr. Uhler. Mr. Chairman, and members of the Committee. We have prepared testimony that is directed at some of the things that need to be reviewed and cleaned up in the Amendment. I submit that written testimony for the record.

We are dealing with the very, very serious business of amending the United States Constitution. On November the 8th, we saw Americans voting against smoke and mirrors government and against the politicians who bring them smoke and mirrors government.

They rejected sound bites in favor of sound solutions.

It is our responsibility, as witnesses here, to help you with this enormous responsibility of preparing a proper amendment. Hopefully, the Amendment will be part of the Constitution for the rest of the history of this nation and we should approach it with that level of deliberation.

It is clear that the American people want a strong amendment. Polling data reveals that. Polls that were taken and introduced at a press conference yesterday with Senator Rod Grams demonstrate that. The people, by a ratio of more than 2 to 1, want an amendment with a strong tax limitation provision.

I think the vote on November the 8th supports that.

Certainly, all the evidence that we have with our members and taxpayers across the country support that.

Furthermore, what you do here is not the end of the process, as you well know. It is one thing for an enthusiastic group of members of the House of

Representatives to change the rules on opening day, and they did that with a degree of clan and great delight. If they did it wrong, they can correct it the next day; Similarly, with a statute, but not with a constitutional amendment.

When you're done with your work, it goes to 50 state capitals and goes under a microscope in these 50 state capitals during the ratification process.

Your reputations are on the line in your state capitals when under that microscope, they find warts and wrinkles. So it's important to do it right, And, as Bill has suggested, if it takes a little longer than the timeframe allocated, we would urge you to take that time, so that it be done correctly.

It seems clear to us that a strong tax limitation provision is key to the future in this measure. With all due respect to Senator Larry Craig, with whom we've had the pleasure of working from the first days that he was elected to the House of Representatives, we would suggest that a rule co-equal to the voting rule on borrowing be placed in the Amendment. It is important that the voting rules are not skewed, and the effort to circumvent the requirements of the Amendment at some time in the future are not distorted. It should be equally difficult to borrow or to tax, so that pressure is placed on constraining and disciplining spending.

Frankly, I think -- and this is a judgment call -- that without strong tax limitation, we may get to the 28th and the 30th and the 32nd state and the 35th state, but we're going to run out of gas in the final states unless the people are content with the notion that this Amendment will not increase their taxes on a regular basis.

Furthermore, I feel very strongly that protection against unfunded mandates should be placed in this amendment -- this is the logical place for it. In 1982, when the Senate passed the Tax Limitation Balanced Budget Amendment, a provision protecting against unfunded mandates was in that measure and was passed by the requisite votes in the Senate at that time.

I'm not smart enough to sit here and tell you the precise words that we should use for the mandates provision. This is delicate business and we certainly don't want to create in the Constitution an authority on the part of the Federal Government to impose mandates on authority that currently does not exist.

I think some of the debate that you are having now on the language for legislation to control unfunded Federal mandates is occasioned by the difficulty of coming to grips with the specifics of the issue.

But I feel very strongly -- I feel strongly that without a tax limitation provision, it (the Amendment) won't be ratified. I feel probably even more strongly that without an unfunded mandate provision or protection, it won't be ratified.

Put yourself in the place of the state legislators. Senator Mack, you're in Tallahassee, or Representative Saxton is in Trenton. You're now testifying and you're urging the ratification of this measure. And your state legislators say, Senator, how do we know that Washington, in its efforts to meet the constraints of this amendment, won't seek to impose on us (the states) its lack of spending discipline at the Federal level?

That's going to be a tough one to answer unless you have a mandate provision in the amendment..

We've talked about, and it's been raised by Representative Stark -- and properly so -- and other members of the opposition in the Congress, how do we get to a balanced budget?

Well, first, we have to have the discipline of a constitutional amendment that provides a framework within which we can make the requisite restraints and cuts.

I would urge what Senator Mack and I suggested about a year and a half ago -- a spending freeze at today's level of approximately \$1.5 trillion. You can actually get to a balanced budget over the next five years with the use of the model of the base closure commission which Senator Mack has introduced in legislation as the Spending Reduction Commission. There is a device that can enable us to get the appropriate reduction each year, as is necessary.

We know there are certain things we've got to pay. We've got to pay interest on the national debt. We have to pay the social security, the quasi-contractual obligations. We have to pay pensions to retired Federal civilian and military employees.

Other things are open to discussion and debate.

My final point would be this -- in the larger view we're trying to place a restraint on government, at the Federal level. Because study after study after study reveal one significant point -- that as government increases in size, it imposes an additional penalty on the opportunity of the private sector -- individuals and families -- to improve their own economic position in this nation, and to fend for themselves and to create a future for themselves.

So we're debating policy for the future about the size of the Federal structure, and therefore, the size and productivity of the private sector, the engine of real economic growth in this country.

Thank you very much.

[The prepared statement of Mr. Uhler appears in the Submissions for the Record.]

Senator Mack. Thank you very much for the testimony from both of you.

I want to welcome Congressman Hinchey, who is not a member of the Committee, but who has an interest in this subject.

We're delighted that you're here.

Representative Stark. Senator, I must apologize. There's a vote on in the House, which will necessitate the House members -- I apologize.

Senator Mack. All right. We will look forward to your return.

Representative Stark. Thank you.

Senator Mack. It is awfully easy to get drawn into the political aspects of the debate. I would like to focus for just a couple of minutes on some of the economic aspects of the debate.

Many critics of the Balanced Budget Amendment have argued that a balanced budget rule restricts the ability of government to respond to economic emergencies such as a recession.

Dr. Niskanen, and Lew as well, would you to respond to that argument? We hear it all the time.

I'd like for you to express your point of view.

Mr. Niskanen. The proposed amendments would in no way restrict the automatic stabilizers in the Federal budget. If economic conditions are stronger than expected at the time the budget is passed, revenues will be hard. There will be a surplus in the budget.

If economic conditions are weaker than expected at the time the budget is passed, there will be a deficit.

So the automatic stabilizers in the Federal budget would still be in place and are in no way constrained by the Amendment.

What is constrained would be discretionary fiscal policy. That would say that it would take a broader majority in both Houses of Congress to exercise discretionary fiscal policy than would be the case if only a majority of a quorum, which is now the present rule.

That is inherent in the Amendment and it is the purpose of the Amendment. But the automatic stabilizers are in no way changed.

Mr. Uhler. Mr. Chairman, if I may add.

Senator Mack. Yes.

Mr. Uhler. This is an opportunity to contrast the two principal amendment delivery systems that are before the Congress. The Simon-Stenholm model, which the Senate has ushered forth from the Judiciary Committee, does require a balance each year. And so it requires that the

Congress shoot at two moving targets -- spending changes and revenue changes -- each year.

The tax limitation model that Joe Barton has introduced in the House and that is the principal one there, was specifically designed to achieve a balance over the life of a business cycle, not each year, because it sets a spending target for each year, irrespective of the outcome of receipts for that particular year.

Therefore, to the extent that people may believe in counter-cyclical effects, the Barton model incorporates that approach in the balance process.

We think it is therefore more likely to be achievable and honored because of its design.

Mr. Niskanen. An amendment to Lew's comments.

The new version of the Senate version, I understand, permits the vote to be based upon estimates, in which case the budget need not be balanced in fact each year, although it was supposed to be balanced in prospect.

So I think that even in the Senate version, as it stands, it would permit the automatic stabilizers to work.

Senator Mack. Just to follow along this discussion, let's assume for a moment a year in which there is a deficit because assumptions turned out not to be correct, the economy slowed down and so forth.

Do you think it's important for the Congress to deal with that deficit the following budget cycle?

Mr. Niskanen. It should be dealt with sometime in the following period because both amendments have a vote on the actual limit on the public debt and that ultimately constrains how much actual debt is run up. And that's an appropriate limit to have in the Amendment.

The reason why we ought to allow deficits, actual deficits, in a particular year is so that we can provide some stability to tax rates and actual government programs.

But the combination of government programs and tax rates should be designed to lead to a rough balance over the period of the economic cycle, and I think the amendments are consistent with that.

Mr. Uhler. Mr. Chairman, if I may add. One of the unique provisions or dimensions of the Barton Amendment is that it does impose a co-equal responsibility on the Congress and the President to assure that actual outlays under the Amendment do not exceed the outlays that are set forth as the spending target.

It is our position that the empowerment of the President is an articulation of what many of us believe is an implicit power of impoundment giving

constitutional-level authority to the President to impound. By virtue of that power (in the President), inviting the Congress, always jealous of its budget shaping authority has an opportunity to adopt a set of rules, possibly like Gramm-Rudman sequestration whatever, most likely to cause the government of the United States to live within the constraints of the Amendment.

Senator Mack. Thank you.

Mr. Niskanen. It is clear that something has to be done with the congressional budget process. Until the Empowerment and Control Act of 1974, appropriations were regarded as a ceiling.

But the Empowerment and Control Act and its implementation over the years has also made appropriations a floor. There's no way to run a big organization where the authorized spending is both a ceiling and a floor.

So, one way or the other, I think you're going to have to give the President some discretion, either in the form of a line-item veto or, more appropriately, I believe, something like enhanced rescission authority to make the system work at all.

Now I acknowledge that President Nixon and Cap Weinberger in that post-Watergate period probably abused the impoundment authority that the President already had. But there is still a problem there from a management of the Federal budget point of view and I encourage you to move quickly and thoughtfully on something like enhanced rescission authority as an essential part of implementing a balanced budget amendment.

Senator Mack. Thank you.

Senator Bingaman?

Senator Bingaman. Thank you, Mr. Chairman.

Let me first just say, Dr. Niskanen, I do think your statement, reading from your testimony -- "Congress is now rushing to vote on these issues by the end of next week. It should take more time to resolve the above issues. Congress should delay the vote."

Senator Byrd agrees strongly with your view. I just thought I'd mention that.

(Laughter.)

Mr. Niskanen. My impression is that's not specific to this Amendment.

(Laughter.)

Senator Bingaman. No, but it is to the unfunded mandates issue, which I think you also believe needs to be very carefully dealt with.

One of the things which Congressman Barton pointed out in his statement was that four of the last five major tax increases did not pass with 60 percent margins in both Houses.

I believe that I voted for those so-called major tax increases because they were in fact deficit reduction proposals which came to the Congress with the support of President Reagan and President Bush and, most recently, President Clinton.

Now his assumption is that we would not have gone ahead with the tax increases had we had this tax limitation provision in.

My question is what assures you that we would have gone ahead with the deficit reduction, had we not been able to do some tax increase as part of it?

Mr. Niskanen. Right. Two points. One is that the votes on those particular proposed tax increases might have been very different if a balanced budget amendment had been in place because they would have been constrained to meet a balanced budget over some interval and that might have changed the votes on these historical proposals.

Second, the unfortunate record of the Federal Government, at least in the post-war years, is that tax increases have not contributed to deficit reduction. In general, they have added to the willingness of Congress to spend. The deficit has not been significantly reduced by the major tax increases of the postwar years.

Senator Bingaman. Let me ask if you agree with these figures because there's been a lot of talk about the Federal Government's portion of the gross national product having grown and grown and grown. And clearly, there has been a substantial increase over a period of time.

This was in a *New York Times* article a week ago. It said: The number of Federal programs cut out of the budget during the eight years of the Reagan Administration can be counted on the fingers of one hand. Moreover, despite the oratory, the government's huge share of the national economy barely budged. It amounted to 22.9 percent of the gross domestic product the day Mr. Reagan arrived in Washington. It was 22.1 percent when he left. It is exactly 22 percent in 1994.

Do you agree with that?

Mr. Niskanen. Yes. On the national income basis, it's 23 percent in Fiscal '94, but the numbers are roughly correct.

Now there was a substantial change in the composition of Federal spending during the Reagan years. There was a substantial shift from discretionary domestic spending into defense, at least during the first four or five years of the Reagan period.

And then an unfortunate increase in the interest share of GDP.

The noninterest share of GDP, however, was lower at the end of the Reagan period than its beginning of the period. But within that noninterest share, there was a shift from discretionary domestic programs into defense.

Senator Bingaman. And there was a substantial increase in entitlement spending during that period as well.

Mr. Niskanen. A substantial increase in entitlement spending. That's right. You should recognize, actually, that the demographic conditions at the present time are more favorable to keeping entitlement spending low than at any time before or we will see in the future.

The birth cohorts in the 1929 to 1939 period were very, very low. And as soon as that generation passes into social security and into the uncertain future, the entitlement spending will grow much faster than it has, unless we do something important.

And one of the reasons why a balanced budget tax limitation amendment is important is to force Congress to pull ahead a deliberation on these very serious long-term issues.

Senator Bingaman. Let me ask --

Mr. Uhler. Senator, if I may add.

Senator Bingaman. Yes, go ahead.

Mr. Uhler. I think one thing is clear from the Reagan period, and that is, once we had Gramm-Rudman in place, we had the lowest year-over-year nominal spending increases in '85, '86, '87, and the lowest deficits.

Now, that tells us something very important about a disciplinary structure. We know it was just statutory, and it was ignored aside, it was abused and it was finally eliminated in the '90 deal, it did have a positive effect.

Now if we incorporate that same concept into the Constitution, then I think we have the kind of discipline that is unavoidable and can achieve the results we need.

Mr. Niskanen. I want to endorse --

Senator Bingaman. Let me ask another question before I run out of time.

Oh, I guess I did run out of time. Sorry. I should have asked my question before I let you talk.

Go ahead.

Senator Mack. Well, again, time seems to be the focal point this morning. We have two Governors that are seated behind you two gentlemen.

I wonder, would you allow us to receive the testimony from the two Governors? At that time, we'll have other members back. We'll bring you back up so that we can continue the discussion.

Mr. Niskanen. We are totally at your pleasure, Mr. Chairman.

Senator Mack. Thank you. I appreciate that.

Governor Allen? Governor Merrill?

We have two very distinguished Governors with us this morning and I want to thank you both for taking the time to be with us. I know that you have very tight schedules as well, and I appreciate the understanding of the previous panel so we could make this change and allow you to testify.

Both of these governors, Governor Merrill, Governor Allen, clearly understand the importance of holding down the growth of government, really shifting opportunity to individuals. And we will probably hear from Dr. Friedman a little bit later, probably no one more eloquent in expressing the opinion that freedom is the core of all human progress.

So I'm delighted to have the two of you here. Governor Merrill, why don't you begin and then we'll go to Governor Allen.

PANEL III

STATEMENT OF THE HONORABLE STEPHEN MERRILL, GOVERNOR OF NEW HAMPSHIRE

Governor Merrill. Thank you very much.

Mr. Chairman, members of the Joint Economic Committee, I come here today, it is a great honor to represent the people of New Hampshire. I am the Chairman of the New England Governors and the Chairman of the Coalition of Northeastern Governors, but I come here today as the Governor of New Hampshire, and I do not speak for those organizations.

I have not come here to talk about percentages or the budgetary requirements, but to speak first about the purpose and the resolve that I believe is necessary to balance the budget of the Federal Government on behalf of the people of this country.

That is why I come here to speak to you on behalf of this Balanced Budget Amendment.

All of us as elected officials recognize the winds of change that are sweeping this country and what you are doing, Mr. Chairman, and this Committee is considering is the beginning of a process that, in my opinion, is the task that the Congress was elected to resolve now. Because for 26 continuous years, the Federal Government, Republicans and Democrats alike, have allowed the tyranny of red ink to grow to the point where it stifles

the very freedom that you have talked about, the very entrepreneurship that you have talked about, and the opportunity to grow this economy in a way that the next generation will enjoy the fruits and bounties that this generation enjoys.

Instead, we are facing higher economic burdens, higher taxes, and a decreased standard of living.

And as Governor of New Hampshire, I've come here to say that we are the State that has balanced budgets for 200 years without a broad-based tax. That means that in New Hampshire, we have balanced budgets without an income tax and without a sales tax.

That is a remarkable accomplishment and one that I'm here to talk about.

It is not a coincidence to me that there has been a change in the House of Representatives in the make-up of the House. The phrases that have always held sway in New Hampshire, such as cutting taxes, prioritizing spending, not allowing a static philosophy regarding economic growth or the taxes that crush that economic growth, they are now prevalent across this country.

We also are the first state this century to pass an unfunded mandates prohibition. I was the Attorney General that went to the Supreme Court of New Hampshire in 1984. We passed an Amendment that said you cannot send unfunded mandates down to the cities and towns without paying for them.

We were told that that would be economic ruin, both at the state level and at the cities and towns level.

It has formed something quite different. It has formed a partnership. We are the only state that, I believe, in the country pays for its local sewer, local water, and local landfill projects because there's a partnership. We will not pass on the unfunded mandates that the Federal Government has passed on to us.

I'm a strong supporter of the Contract With America because I believe that it will reflect the values that are already existent in states like New Hampshire. It is not coincidental, as one of your prior speakers mentioned, that Gramm-Rudman was formulated by one of the senators from New Hampshire, a former Attorney General himself, Warren Rudman.

Let me tell you how we do not pass on deficit budgets.

In New Hampshire, it is against the law for a sitting governor to submit an unbalanced budget.

In New Hampshire, it is against the law for the Finance Committee to propose a budget that is in deficit to the House.

In New Hampshire, it is illegal for a department head to deficit spend.

And New Hampshire has created a Revenue Stabilization Act, which is commonly called the Rainy Day Fund, in which we take 5 percent of the state's surplus and we preserve it for future economic downturn. This fund cannot be invaded without a super-majority of the legislature in New Hampshire invading it.

This makes a difference.

And let me repeat -- that is why we have not had a balanced budget amendment in New Hampshire, and yet, we have balanced our budgets for 200 years.

All governors that you have heard from on a variety of matters, including in the Contract With America, have told you what it's like to be on the front line trying to balance a budget with the unfunded mandates that are sweeping down on us.

I did something rather interesting when I was elected. I was the first governor in modern times to reject the number that the House came up with for their budget and to reject the number that the Senate came up with for their budget. It was assumed that I would simply choose the number in the middle. I'd accommodate and we'd move on.

I came up with a number that I believed was absolutely necessary for New Hampshire to come out of the worst recession since World War II. It was a number lower than the House and lower than the Senate and it was accepted.

I think that is precisely what we need to do. The most sweeping change in New Hampshire's tax code in the last 25 years included a super-majority provision. I think that is essential to restore economic growth and economic prosperity.

Let me conclude by saying, was it easy? No. Will it be easy for the House and the Senate? No.

But as a result of cutting three taxes and eliminating two more in New Hampshire, you need to know what's happened to our economy because in doing so, I will answer the obvious question -- how do you balance a budget without an income tax or a sales tax?

We do it by prioritizing spending. And as a result of what we've done, the CATO Institute published a study in *The Wall Street Journal* that gave us an A, the finest ranking in the country for the management of state government and fiscal responsibility.

We have been cited by Ralph Nader, who doesn't love New Hampshire, as having the finest developmentally disabled services and the finest mental health services in the country. We're first in child care and first in care to elder citizens in the nation.

So it can be done. What it takes is political resolve and I'm here to support you in that effort.

Thank you very much, Mr. Chairman.

Senator Mack. Governor, thank you very much for your testimony.

Governor Allen?

[The prepared statement of Governor Merrill appears in the Submissions for the Record.]

STATEMENT OF THE HONORABLE GEORGE ALLEN, GOVERNOR OF VIRGINIA

Governor Allen. Thank you, Mr. Chairman, members of the Committee. It's a pleasure to be with you all this morning.

I wanted to share with you some of my experiences in Virginia as Governor, as well as some of the experiences I actually had as a member of Congress, and why I believe it's very important to bring some accountability and clearly, some discipline, to government at the state, as well to the Federal level.

Your previous panel had former Congressman Kyl. When I was a member of Congress, then-Congressman, now-Senator Kyl, and I had the Republican alternative for the balanced budget.

Our plan had various provisions, some of which are not in the ones being debated now. We had a limit on spending of 19 percent of the gross national product. That way, you'd want to have pro-growth economic policy.

We also had the three-fifths vote for any tax increases or anything going outside the balanced budget. And we provided to the President the power that I believe at least 43, 44 governors have, which is the line-item veto, which adds additional scrutiny to any particular program or spending item.

Now, clearly, there is a problem up here in Washington with spending. Everyone knows that. And it's obviously undisciplined.

To reduce spending, though, even at the state level, is not an easy task.

Now, we in Virginia have a requirement of a balanced budget. I think that a balanced budget requirement needs to be in the Constitution of the United States. It is something that I think will bring accountability and discipline in Federal spending.

Now it's not unusual. A lot of folks act as if, gosh, what an oddball, unique idea, to have a balanced budget requirement in the Constitution.

Virtually every state has a balanced budget requirement in their constitutions. And I think it forces a discipline into our states. It forces the governor

to accept responsibility. The Governor in Virginia, as Governor Merrill said in New Hampshire, the governor must submit a balanced budget.

We have in our budgets, though, biennial budgets, a two-year budget, and it has to be in balance during that period as well. So there can be amendments in between. Now it's not easy. A lot of people say it's a good idea. It's just wonderful. There will be rainbows every time it rains and so forth if we have a balanced budget amendment.

It is not at all easy. What I'm trying to do in Virginia is give the biggest tax cut in history, a \$2.1 billion tax cut so that working families and working taxpayers can keep more of their earnings and also repeal something called the gross receipts tax, which is generally a despised tax on businesses.

Now in doing that, you would think, gosh, everyone would be for it. But believe me, you'll see it here. I see it in Virginia. These entrenched special interests -- folks who are used to getting money from the government -- if they don't get everything they ask for, you are accused of being against everything in the world. They couldn't care less about what the truth is because, in the effort to get more and more money and keep more and more of the taxpayers' money, they come up with every scare tactic, fearful prediction, and so forth.

So you are going to have a heck of a time on your hands balancing this budget.

You all -- I'm not saying you in particular but the Federal Government -- has institutionalized certain programs. And you want to get things down to some sort of semblance of order and keep spending within line with your revenues coming in.

It is going to be absolutely the most difficult task that you'll have.

But with the balanced budget requirement that the Constitution will give to the Congress as a whole, the Federal Government as a whole, is that added cartilage for their backbones, the cartilage in the backbone to say, no, I'm sorry. The Constitution requires us to have a balanced budget. No, we cannot spend money on these programs.

It forces you to prioritize. And in submitting my tax cuts in Virginia, I had to commensurately reduce spending. And that's why you get all the carrying on for these spending reductions.

We wanted to be focused on the essential responsibilities of the state government, which, in my view, are job creation, education, and law enforcement.

But even if you do have a priority in education, or whatever the program is, it doesn't mean you keep running it the same old way.

Unfortunately, so often the way that someone determines that you care for a particular function of government is by how much money are you spending. But you can do things more efficiently. You can determine what are the key responsibilities of the Federal Government and then stay out of things that really are not Federal affairs. They are the affairs and the prerogatives and the rightful prerogatives of the people and the states.

Now as you go about this, you're probably going to hear from some of our fellow governors being all concerned about this. There will be less money coming in from Washington to the states.

Well, I think that the only real and legitimate concern in that regard is if you all start sending down unfunded mandates and say, you all in the states and you people in the states have to do these and perform these various functions. Or if you commandeer the people of the states to be just minions and administrators of Federal dictates, whether they're regulations or whether they are statutory laws from up here.

And that is a legitimate concern. And I certainly do urge you all to pass that unfunded mandate legislation. Eventually, I think that that should be put into the Constitution as well for an added protection.

I do think, being from Virginia, that you all need the restraint. You know the record here of how few balanced budgets you've had recently.

I always like to quote my favorite, Mr. Jefferson. I always call myself a Jeffersonian conservative. But Mr. Jefferson was concerned about debt and the propensity of people in government to keep getting re-elected by giving out more and more programs and being able to take someone else's money and give it to someone else to curry favor.

Mr. Jefferson said: "In questions of power, let no more be heard of confidence in man, but bind him down from mischief by the chains of the Constitution."

That was one thing, unfortunately, that we did not put into the original Constitution. Your debt -- the debt and the interest on the debt -- is clearly increasing to a point where you're not going to be able to provide for essential services.

In Virginia, we have an AAA bond rating. We do not allow our interest on our debt to be any more than 5 percent of our general fund revenues. And right now, it's in the 3 percent range.

And so, we keep an AAA bond rating.

But I want to say that I do support as the preference the Balanced Budget Amendment that requires a three-fifths majority for tax increase. I am proposing a two-thirds majority for Virginia income or sales tax increases.

My general view is you'll have to make those tough questions, tough decisions. No doubt about it. But the basic premise is that the people who earn that money, whether it's that small business or that mother or father who's trying to provide for themselves and their family, they know a whole lot better than we in Richmond or you all in Washington about how to spend that money than the inefficient way of sending it to the government and sending it back.

So you'll make these tough decisions. But I think for a change, I think that we ought to be doing what is right for the taxpayers, as opposed to what's convenient for the government.

Thank you, Mr. Chairman, and members.

[The prepared statement of Governor Allen appears in the Submissions for the Record.]

Senator Mack. We again appreciate your testimony. The two of you represent a very strong message of the do-ability of what we're talking about.

Someone mentioned earlier this morning that there is a real effort to scare everyone at what this amendment is going to do. And I think your testimony, frankly, is very important in this debate. I appreciate the fact that you are here.

I don't know what your time is. I don't know whether you would be willing to take, say, another five or ten minutes of questions.

Governor Merrill. I'd be happy to.

Senator Mack. Then that will allow me to get the other panel back up before we get to Dr. Friedman via the satellite.

And at this point, I would turn to Senator Bennett, who has not had an opportunity to make a statement today at all. And maybe you'd like to ask a question.

OPENING STATEMENT OF SENATOR ROBERT BENNETT

Senator Bennett. Thank you, Mr. Chairman. I will not ask a question because of the interest of time.

I would simply make this comment about the debate that we've been having back and forth about the applicability of tax increases towards deficit reduction.

When the top marginal tax rate was 90 percent in this country -- and I tell people that. They deny it. I tell people it used to be 90 percent. They say, no, it never was. Yes, it was 90 percent from the New Deal.

The amount of Federal revenues out of the gross national product was roughly 19 percent. When the top rate got dropped to 70 percent, the amount of Federal revenues from the gross national product was roughly 19 percent. When the amount was dropped to 50 percent by John Kennedy and the Congress, the amount that the government received was roughly 19 percent of gross domestic product.

Are we picking up a pattern here?

In the disastrous "Reagan tax cuts" -- I put that in quotes because it's not my point of view -- how badly was the Federal Government hit?

Somehow, we got 19 percent of gross domestic product after the disastrous Reagan tax cuts gutted our opportunity to fund everything.

The fact is the American people are very inventive and they will find ways throughout any tax code through tax avoidance and changing of economic activity, that it seems to be the most we can collect happens to be stuck at pretty close to 19 percent of gross domestic product and it's been there for 40 years.

The Senator from New Mexico has pointed out that we are spending at the rate of somewhere between 22 and 23 percent, consistently. It happened through the Reagan years. Still going on.

You don't have to be a rocket scientist to figure out that if 19 percent is the most we can collect no matter how we fiddle with the tax code, 19 percent had better be where we start spending because that 4 percent gap extrapolated for another 50 years is going to destroy us and there's no way to deal with it except to get the 22 percent back down to 19, which is where it used to be.

That's my contribution to this morning's conversation.

I will say, perhaps a cheap shot, but I can't resist it. I'm very troubled about writing a balanced budget amendment into the Constitution. I would much prefer to do it with statutory language that can be amended.

But the more I hear the gentleman from California, the more convinced I am that a balanced budget amendment probably is indeed the way to go, and I credit him with firming me up on this position.

Senator Mack. Senator Craig?

Senator Craig. Governors, thank you very much.

Governor Allen, you've had the experience of voting for a balanced budget amendment to the Constitution. Now while you supported a spending limit in the Kyl form, my record tells me that you ultimately voted for the version that came out of the Senate and the version that was the Stenholm-Smith version.

If that version, if a version that required a constitutional majority to raise taxes and had the three-fifths in it for debt ceiling and the estimator in it so you don't get the rosy scenarios, but you do have the flexibility, if that comes to the state legislature of Virginia, will you recommend its passage?

Governor Allen. Senator, Senator Bennett's comments on the 19 percent was exactly why the Kyl-Allen amendment had 19 percent. So you do have a pro-growth economic policy.

Senator Craig. Yes.

Governor Allen. That was my preference, obviously.

The second one, there were several of them that came up in 1992. The second one --

Senator Craig. But there was the one that finally got to the king of the hill, if you remember.

Governor Allen. Right, and I supported mine, of course, with Jon Kyl.

Senator Craig. Yes.

Governor Allen. Supported the Barton one as well, which I thought was the second best. And then came the one that was as you stated. And I did support that because, while it is not what I think is the ideal or the best, I think it is necessary.

The discipline is needed to be put into the United States Constitution. Senator Bennett mentioned legislation. You've tried it. The Federal Government has tried legislation, Gramm-Rudman. It's failed. It's ignored.

If it's in the Constitution again, I think it will give that backbone to it.

Is it the best? No. But it's a whole heck of a lot better than what you have now. For the members of the Senate and the House of Representatives, when they take that oath of office to uphold the Constitution of the United States --and especially with the climate of the taxpayers out there who are working for a living and paying for this government and paying for everything else -- I think it will hold their feet to the fire and I certainly would support it and would encourage you to do so.

If that were sent to the people of Virginia through their legislature for ratification, I would wholeheartedly support it.

I would also caution you, though, that what would help a great deal before that is sent to us for ratification is that you also pass S. 1, the Unfunded Mandates Bill, so you don't give the people who will come up with every guise and every ruse and every excuse to be against it, to find a reason to vote against it.

So I would support it.

Senator Craig. Governor Merrill?

Governor Merrill. I agree. Let me say that, as a former Attorney General, I approach amending the Constitution with great reluctance.

I agree with Senator Bennett's comments and I believe that there should have been the political will in this body to do it without amending the Constitution of the United States.

But having looked at the political landscape, I believe that this is required. And I believe that the super-majority will make it effective and I believe that other legislation will be forced to make it effective. But I will go to my state legislature and I will urge them to support this Balanced Budget Amendment.

Senator Craig. Thank you, gentlemen.

Thank you, Mr. Chairman.

Senator Mack. Senator Bingaman?

Senator Bingaman. I'd just like to ask both Governors an obvious question which comes up every time this is discussed. And that is that there may be a difference here between the budgets that you're talking about balancing and taking such pride in balancing and the Federal budget.

Yours, I assume, like most states, have an operating budget and you have a capital budget.

We do not have that distinction at the Federal level. When we decide to invest in infrastructure, it is reflected in the overall budget and it comes up as deficit in the Federal budget, even though it may be many years for us to pay for that aircraft carrier or whatever the item is.

Now that's not true in your budgets, as I understand the way you budget at the state level. It certainly is not true in my State of New Mexico.

We can make a decision in New Mexico to invest in infrastructure and not have that listed as part of the debt that we're incurring in our operating budget.

So I guess the obvious question is, if we do this, if we have a balanced budget amendment, if we go to a balanced budget situation, would you favor us also going to a capital and an operating budget at the Federal level, just as you have at the state level?

Governor Merrill. Senator, you're absolutely right. We have an operating budget and a capital budget in New Hampshire. We also demand that every budget reflect the accurate revenue picture and the accurate debt structure.

So, for example, our Section 3 of your Bill, we do include debt service in what this Amendment refers to as the receipts and outlays for fiscal years.

Debt service is included in the New Hampshire budget. We do have an operating and a capital budget.

I agree with you that there is a requirement for capital expenditures that may not necessarily be reflected in the operating budgets. I would simply tell you that to come to grips with that question, I asked my fiscal people before I came down here, what is the debt of New Hampshire as opposed to the total budget picture, and compare that to the Federal Government?

And I was told that one-quarter, including all bonded indebtedness, anything that can be called debt in New Hampshire, amounts to one-quarter of our total annual budget, and for the Federal Government, your total debt is three times the size of the annual Federal budget.

So that will give you an idea of how well we have come to grips with it at the state level, and I would certainly agree that anything that you need to do to get an accurate and realistic view of how to hold down the debt is appropriate. And if that means that we have to separate it into an operating and a capital budget, I would favor that, as long as it isn't an excuse for higher taxes and more spending.

Governor Allen. Senator, I alluded in my remarks our debt in Virginia and how we try to manage that.

First of all, in our budgets, as you have also, we have your trust funds. We have the aviation trust fund, the transportation trust fund. I, of course, make sure, as best I can, that we certainly haven't raided those trust funds to somehow pay for nontransportation needs or nonaviation needs.

What we have is a group called the Debt Capacity Advisory Committee, which is made up of members of the executive branch. Senator Robb, I think it came in after you were Governor. But, nevertheless, it's made up of both parties, members from the legislature, advisors and so forth, to advise us on our debt capacity.

We have imposed upon ourselves in Virginia a requirement that interest or the debt financing or debt service, whatever term you want to use, can be no more than 5 percent of our general fund revenues. And we have kept to that. Right now, it's in about the 3 percent range and we are one of only four or five states in the nation with an AAA bond rating. And that is something that we pride ourselves on in Virginia. It is something that is important.

So, to the extent that we do want to use bonds -- and we do currently in Virginia use bonds for capital improvement (colleges, prisons, in some

cases, roads, mental health facilities, those are generally what it's been used for) -- it still cannot be more than 5 percent of our general fund revenue.

And to the extent that you do use bonds for those, if you have an AAA bond rating, the interest costs you have to pay to the bond holders is less.

So, in the event that you do want to do something like that, you'd have to determine what are capital expenditures, such as buildings. I suppose if you had courthouses, something like that, where you're paying off the cost of that project in its early useful life, it might make sense.

But how you all do that here is up to you all. You can look at the various states and I think you'll find some pretty good ideas on how to put that discipline into it.

Senator Mack. If I could, Senator Robb has just arrived and I think that he would like to make a comment. Again, I just would say to folks, we're running late, time-wise, and I've got to get the other panel back up.

Senator Robb. Mr. Chairman, I thank you. As I think you may be aware, except for Senator Bingaman and myself for these two moments, almost all of the Senators in the now Minority side of the aisle are over in the Georgetown Conference Center on an issues day retreat. But I wanted to come back as a courtesy to the Governor of my own Commonwealth. And Governor Merrill, delighted to have you here as well.

Governor Merrill. Thank you.

Senator Robb. I remember a little over a decade ago coming up from time to time. It was always reassuring that other members of the Virginia delegation were interested in what our Governor had to say, and I appreciate your coming to be with us.

I was just looking through Governor Allen's prepared testimony. I'm not sure whether I caught everything or not. But I would appreciate just one comment, if I could, from the two governors with respect to the concerns raised by the lack of Federal spending if we do in fact get to a balanced budget.

I think most people who know me know that I am probably more draconian than most in my desire to move in that direction and would make some choices that others might not make.

But, nonetheless, there are projections in Virginia's case of about a billion dollars. I don't know what the case is with respect to New Hampshire. But a very significant reduction in the amount of Federal spending that would come to or take place within the states involved.

If the governors have not already addressed that, given their advocacy of the Balanced Budget Amendment, just a comment on that would be very welcome.

Governor Allen. Senator, as you well know, in Virginia, we have a balanced budget. And as governor, you were compelled and did it as well.

Our concerns as governors, I think the main concern, as I stated earlier, were unfunded mandates being shoved down our throat and just commandeering our states as administrators of various things.

That is the main concern.

If there is reduced funding, we're prepared to do it. In Williamsburg last year, in November, a majority of the governors got together and said we would take reduced funding or block grants, if we could get more freedom on how to operate various programs.

And so, I understand as a governor that there would be less money coming from the Federal Government one way or the other. You're going to have to reduce spending over a period of time as you ratchet it into a balanced budget situation.

But I think that that's to be understood. I think anybody with any semblance of the difficulty of the task here would understand that.

There already have been comments about reducing agriculture and the extension agencies from the Federal level. I'm trying to do that at the state level. You get all sorts of carrying on about how you need to teach restaurant owners to heat meatballs to 160 degrees to kill bacteria. That doesn't strike me as an important thing for extension agents to do.

But, nevertheless, that's the sort of stuff that you hear.

So, as long as the reductions don't force us to do things that are unfunded, I think more appropriately of the discipline and accountability that will be forced upon the Federal Government. As you realize now the Federal Government was designed and created and formed to provide a national defense. That will be number one.

As far as education and welfare reform, let us do it. We can figure that out. Those are -- especially education is -- a state and local responsibility and I think the Federal role is absolutely nil in it.

I don't want to cause a whole debate on that. But if that's where you all could be making some decisions about saying, hey, let's trust the people at the state and local level and let's read the 10th Amendment once again.

Governor Merrill. Mr. Chairman, I agree with Governor Allen's remarks and I'll reserve the rest of my time.

Senator Mack. Okay. Again --

Senator Robb. Mr. Chairman, could I just say, thank you, for allowing me to do this and say that the continuation of the federalism debate is one that I certainly welcome and I plan to join in a very significant way.

And I know that, again, over a decade ago, the NGA had this at the top of its agenda, and I hope that between the Congress and the Governors' Association and the state and local governments, we can continue.

Mr. Chairman, I thank you.

Senator Mack. Yes. Thank you. Again, I thank the two governors. Thank you for being here.

Governor Allen. Thank you very much, Mr. Chairman.

Senator Grams. Mr. Chairman, could I just ask one quick question?

Senator Mack. Thank you very much. We're not going to go to --

Senator Grams. You're not going to allow it?

Senator Mack. I'm not going to allow the request. Very friendly denial.

(Laughter.)

Governor Allen. He has good ideas. I've heard him on TV.

(Laughter.)

Senator Mack. First of all, let me express to you my appreciation for your indulgence.

I will now turn to -- Dr. Chimerine?

Mr. Chimerine. Yes.

Senator Mack. I wonder if you would make -- we have your statement. Make a very brief statement and then allow us to get back into the questions.

We're constrained here by a television time of noon.

**STATEMENT OF LAWRENCE CHIMERINE,
MANAGING DIRECTOR AND CHIEF ECONOMIST
ECONOMIC STRATEGY INSTITUTE**

Mr. Chimerine. I will, Mr. Chairman. And thank you for allowing me to make a statement, even though I'm a little late.

I've submitted a fairly long statement which I assume will be included in the record, let me just make some very short comments.

No one over the years has talked more about the need to reduce budget deficits than I have, including at many hearings before this body. The deficits have to be reduced. It's necessary to promote more savings and investment in the long term, and to raise living standards.

But I very strongly am against a constitutional amendment to balance the budget. I think it is the absolute wrong approach. It is bad economic policy, bad social policy, and bad constitutional policy.

With respect to the economic arguments, there's no reason why we should always be balancing the budget. It is counter-cyclical. It will force us to take steps which will worsen recessions, such as raising taxes and lowering spending.

It probably will force cuts in the wrong kinds of programs. And it won't work, as I'll get to in a moment. Even if we wanted to put budget deficits on a downward path in the future, the year 2002, which has been picked arbitrarily, may be too soon to bring about a balanced budget because it will create huge fiscal drag over a short period of time. It may be necessary to choose a much longer period.

The big issue, however, is that you can't legislate to repeal the laws of arithmetic. So my major concern is that it is not going to work, particularly if you combine a balanced budget amendment with the 60 percent rule on tax increases, if you exclude social security and defense from cuts.

I keep hearing people saying that it shouldn't be too painful. All we have to do is cut spending by 10 percent from what it would be and we'll balance the budget.

That's misleading because we've exempted approximately 60 percent of the budget already with defense, social security, and interest. More will probably be exempt. This means it will require 30 to 40 percent cuts in all other programs, on average, which will devastate some of those programs. In many cases these programs are useful and desirable. Some of them should be cut.

We'll be cutting programs that are the easiest to cut, not necessarily the ones that should be cut.

This suggests it's just not going to work. I predict a repeat of the 1980s, if we enact a balanced budget amendment.

Yes, it will force some cuts in spending, some that are desirable and should have been made long ago, and some that probably are not desirable.

However, if we're lucky, those cuts will match the tax cuts we're on the verge of enacting, perhaps slightly more, and will do little to reduce the deficit. And we will be in a position in two or three years when it will become obvious that we're not on a glidepath to a balanced budget. So, we'll resort to gimmicks, optimistic assumptions, taking stuff off budget, and a whole range of other approaches in order to address the problem that will just delay the solutions much like the rationalizations and arguments we

heard in the 1980s -- such as tax cuts will pay for themselves; all we need to do is cut a little waste, fraud, and abuse out of spending and we'll balance the budget; we will grow out of the deficits, etc..

In sum, it's just bad policy. And if you exclude those components of spending that are now being excluded, there is virtually no chance arithmetically of achieving the target of a balanced budget in the year 2002.

It will invite cynicism. From every perspective, in my opinion, it is the wrong policy.

I urge you to reduce the budget deficit the good old-fashioned way -- by putting programs in place that will produce meaningful, reliable reductions in future deficits and you don't need a balanced budget amendment to do that.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Chimérine appears in the Submissions for the Record.]

Senator Mack. Thank you for your testimony. I will now turn to Congressman Saxton.

Representative Saxton. Thank you very much, Mr. Chairman. Let me just pose a question and you all can take a shot at it, if you will.

As you know from watching us operate here over the last several decades, from time to time, the issue of balancing the budget becomes a very, very popular thing to talk about. There have been attempts from time to time to balance the budget.

And, of course, there's a mix that is normally put together to be part of the solution. On the one side, obviously, if we reduce spending, we can move toward a solution. And if we, on the other hand, it has been said, increase taxes, we can move toward a solution.

I wonder if you could give us your perspective on how that has worked, what the results have been, and if you could do that as specifically as you can so that we can look at what we've historically done and try to fashion a solution to the future that takes into consideration what works and what doesn't work.

Mr. Niskanen. Mr. Saxton, my judgment is that Gramm-Rudman worked moderately effectively. For three years, fiscals '87, '88, and '89, the deficit was about \$150 billion. That's \$50 billion-plus smaller than anything we've had since that time.

Now Gramm-Rudman finally fell victim to two things. One is the 1990 and 1991 recession, in which they were not willing to carry -- you and your colleagues were not willing to carry Gramm-Rudman through that period.

And second is that during the Reagan period, there was a substantial reduction in domestic discretionary programs and an accumulation of demands for more spending in those particular areas.

But for the period of time that Gramm-Rudman was in effect, it worked fairly well. There was no tax increase during that period and the deficit came down rather sharply to the \$150 billion range.

Now, if you look at the Congressional Budget Report that was reported in 1989, their projection of the deficit for the years since 1989 was lower than in fact what we have had at any period of time. Although we have had two significant tax increases in 1990 and again in 1993, those two tax increases have not generated deficits that are even as low as what the Congressional Budget Office projected in 1989 with no tax increases.

So I think the record is quite consistent, is that tax increases, with rare exception, have not contributed significantly to reducing the deficit, whereas growth-oriented economic policies and spending restraint have proved to be the most effective ways of reducing the deficit.

Now Larry's right in saying that it is not arithmetically necessary to have an amendment in place to reduce the deficit or to balance the budget.

The same thing could be said about the protections of the First Amendment, in the sense that Congress could restrain from establishing a church. They could restrain from restricting free speech without an amendment. But for very good reason, we have chosen to have a First Amendment and take it seriously now for 200 years, and that it has contributed enormously to restraining the normal pressures of members of Congress and others to take actions that might have established a church and might have restrained free speech, might have restricted our liberties in a number of other ways.

The Amendment is to give members of Congress a constant reminder about what the general community supports as an objective, in this case, on fiscal policy.

Senator Mack. Congressman Manzullo?

Representative Manzullo. Thank you. You know, one of the equations that's been left out, not intentionally, by two of our colleagues who are not here testifying, two of the members of the body where I serve, is the impact upon just regular, ordinary people.

In the chapter called "Generational Forecasts" in the official U.S. *Budget*, it states that because of the \$4.8 trillion debt, every child born after 1993, by the time that child enters the work force, will have an effective, local, state and Federal tax rate of 94 percent.

I think that's obscene. It's absolutely obscene and this country and this Congress has to be thoroughly embarrassed over the fact that it does not have the guts to cut back on spending. And that's witnessed by something as simple as whether or not to privatize Big Bird.

This whole argument on the Corporation for Public Broadcasting, which is an organization without which we can live, and the fact that members of even my party cannot agree to cut, means that we need some discipline in the forms of another chain in the Constitution, of which Mr. Jefferson spoke.

And Mr. Chimerine, you're absolutely right that we don't need a balanced budget amendment if Congress were responsible. But this Body's not responsible and therefore, it needs a big stick to whip us into shape so that the children born after 1993, those kids in this country have a chance.

As it stands now, we're on a giant slide, a quick slide towards socialism, and we need to stop that in a hurry.

I'm sorry. That's a comment, it's not a question, but maybe that is for you, Mr. Chimerine.

Mr. Chimerine. Well, I think all of us here agree that what we've done over the last 14 or 15 years in running these big budget deficits is putting a huge burden on future generations that should have been stopped a long time ago, and we'd better stop it now.

We're talking about tactics. I think you illustrated the point, at least my point. In long debate about whether to cut PBS funding, we're talking about a nit. We're talking about a rounding error.

We are not going to get close to a balanced budget unless we address the entitlement programs--the health and pension entitlements, especially. And if you take them off the table, it doesn't matter if you have a balanced budget amendment because you're not going to get close to it anyway.

Representative Manzullo. But even before that, we can't even agree on Big Bird. We're talking about taking money away from seniors and here we're worried about depriving people of the opportunity to see a Big Bird dance on television.

Mr. Chimerine. I agree. But you cannot legislate courage and you cannot repeal the laws of arithmetic.

What I'm suggesting is that most likely it will lead to a whole batch of gimmicks in the budget process, such as taking stuff off budget.

People don't want to face up to the tough decisions. They will find ways around it, with or without the Amendment.

Representative Manzullo. But Mr. Chimerine --

Mr. Uhler. May I add, Mr. Manzullo?

Representative Manzullo. I'm sorry. Yes, sir.

Mr. Uhler. May I respond? What we're talking about is creating a framework for responsibility, as you have outlined. Since the system has demonstrated irresponsibility and the founders gave us a way to correct the errors that we detect in the structure of the Constitution, we are simply taking that opportunity to correct the error and create a new framework.

As Bill Niskanen has outlined and I mentioned before, Gramm-Rudman, though a Statute, helped us get partway there. It showed what a disciplined process or structure can produce.

I believe that with this in place, with the Congress backing off of requiring through its appropriations process that the ceiling be the floor of expenditures, that we can get there.

As late as the Truman years, appropriations by this Congress always said, here's the amount. This is the do-not-exceed amount. And Mr. President, if you can save money from this, fine.

We have turned that on its head. We haven't allowed the President. So we should give him at the same time line-item veto, impoundment authority, *et cetera*. Then the two bodies working together can achieve the result that the Constitution will impose.

Representative Manzullo. You know, the difference between how the two governors run their states and how we run the Federal Government is they don't have the ability to print money, and we do. We just start printing money and say, well, we'll just add to the national debt.

They can't do that. So we do need the chains of that Constitution.

Thank you, Mr. Chairman.

Senator Mack. Senator Grams?

Senator Grams. Thank you, Mr. Chairman. I'll just make this quick and brief because I've heard some of the testimony from some of the senators and congressmen from the other side of the aisle.

And basically, it sounds like they're under the philosophy that we can continue business as usual and that we can continue to borrow because we in our own private lives can carry debt and there's nothing wrong with the Federal Government doing it.

But as Don said, I think the Federal Government has bought a house much bigger than we can afford.

And I've campaigned many times and told many people, I believe our backs are against the wall and we don't have many options but to balance the budget.

Would you agree that we can go on the way we are, or do you believe that we have to make a real mid-course change? And what would happen if we don't?

I've seen the curves and there's a lot of people -- I worked in the media for 20 years, so I worked with words and not so much with numbers. But I have bankers on this Committee that seem to believe that we can continue, despite what the numbers are telling us in out-years.

So what happens if we don't?

Mr. Niskanen. The best evidence that the budget is not sustainable is two-fold. One is that the ratio of interest payments to GDP has been increasing now for 15 years.

The second is that we will not be able to maintain the level of programs that we have now without a progressive increase in tax rates.

Now whether they have to go up to 80 or 90 percent, as Larry Kotlikoff and other serious scholars have estimated I think is not as relevant as the fact that we will have to have substantial increase in future tax rates in order to maintain current programs.

And I think, and you probably agree, that the American people are not going to pay for that. So the budget is clearly unsustainable.

The primary economic consequence of it is that we will have to be increasingly dependent upon borrowing abroad. That will mean that foreigners will own an increasing part of the capital stock that is located in the United States. The economic returns from that capital will accrue to foreigners rather than to our children.

Pete Peterson, in his Concord Coalition Group, have called deficit financing, fiscal child abuse. I think that's an appropriate term. We are passing a burden to our children and to their children without their knowledge and without their consent and, in that sense, the deficit is fundamentally a moral problem and we should do something about it very quickly.

Mr. Chimerine. Can I make one quick comment?

I think all of us agree with your comment. But in my opinion, our backs are against the wall.

The best thing you can do is to introduce legislation for meaningful entitlement reform in the United States. That will have a far bigger effect on reducing future budget deficits, in my opinion, than enacting a balanced

budget amendment in its current form, with defense and social security and interest, *et cetera*, off the table.

We're only talking about how to bring about the desired result. That's what the issue is. And I'm suggesting that the Amendment, at the same time that we're talking about cutting everybody's taxes and at the same time we're taking more and more things off the table, will not achieve the objective you're after.

Senator Grams. Thank you.

Senator Mack. Congressman Thornberry?

Representative Thornberry. Let me ask just briefly if you might have a comment on the criticism that's made that the courts are going to end up running the government if a balanced budget amendment passes.

Do you have any opinion on that?

Mr. Uhler. It depends on the design of the amendment. That's one of the reasons that we feel that the Amendment that we've helped shape, the Barton Amendment, which gives co-equal authority and responsibility to the President and the Congress to assure that the limits are sustained, is the one that is both enforceable by those two branches and the least likely to invite the incursion of the judicial branch.

Mr. Niskanen. May I refer you to the testimony of former Attorney General Barr on this matter before a congressional hearing earlier this week on just these issues?

He's very sensitive about the courts getting involved in budgetary disputes. His evaluation on this is, I think, to the point, very much to the point.

Senator Mack. Senator Craig?

Senator Craig. I'll be brief. It looks like we're about to plug into Milt out in Palo Alto.

Mr. Chimerine, you had mentioned, and I think your phrase was, a huge fiscal drag by the year 2002. Let me set up this scenario, then.

Congress passes a balanced budget amendment. 2002 is the deadline for balance. The 38 states ratify it and the Congress gets on with the business of getting it done.

Congress doesn't pass a balanced budget amendment, but we wake up tomorrow morning infected with a unique virus called fiscal responsibility. And we decide to pick the year 2002, anyway.

Now, we don't have the Balanced Budget Amendment, but we've got this new disease and before the doctors can get to us to solve the problem, it's the

year 2002 and we've balanced the budget. We've gone in maybe three years down the line, or four, and made some adjustments in entitlements. We've cut programs. We may have knocked a few agencies in the head.

We've done a lot of different kinds of things, and we did so largely through spending cuts and no tax increases.

Would we still have a huge economic drag by the year 2000?

Mr. Chimerine. Oh, yes, we would.

Senator Craig. Why? No economic growth? No stimulus to the economy? No job creation?

Mr. Chimerine. What I'm suggesting is that cutting spending or raising taxes by that amount in such a short period -- we're talking about essentially a six-year period by the time all this gets ratified or by the time we put these budget packages and program changes in place-- over a five- or six-year period, taking that much out of spending or raising taxes that much would potentially slow the economy very dramatically.

We shouldn't lose sight of one factor. Unlike any state government or any local government, the Federal Government has the responsibility for macro-management of the economy. And fiscal policy is one of our major tools to do that.

We've gotten ourselves in such a deep hole, that it may take longer than five or six years to get to a balanced budget, if that is our objective, without creating too much of a drag on the economy, particularly since we're running big structural trade deficits and we're now confronting much higher interest rates.

Senator Craig. So reducing growth rate in government from six percent to three percent could cause a huge economic drag by the year 2002.

Mr. Chimerine. It could cause a significant drag, correct.

Mr. Uhler. Where does the Constitution say that the Federal Government is in charge of running the economy of the United States? I don't find that in any of the delegated powers or any of the implications.

It is precisely because the Federal Government has so invaded the productive resources of America that we're in the trouble that we are. And I don't think there's any question; one doesn't have to be a disciple of supply-side economics to agree with the premise that if you unleash the private inventiveness and creativeness of people and leave resources in the hands of those who produce them, they've already demonstrated their ability to produce and they will produce more.

So we will grow this country at a much more rapid rate and solve these problems.

Mr. Niskanen. Larry's conclusion does reflect a major disagreement within the profession and you should realize that.

I find it difficult to understand how a path towards a balanced budget that includes an increase in the absolute level of spending every year over that period represents fiscal drag.

Senator Mack. Yes, that really invites a lot of comments on my part, but, again, trying to keep this moving, I've got to at this point say to you all, if you want to stay, we'll add Professor Milton Friedman to the panel and we will then continue on with our questions.

Again, you're welcomed to stay if you'd like to.

Mr. Niskanen. Thank you, Mr. Chairman. I must go.

Senator Mack. All right.

Mr. Niskanen. Thank you very much.

Mr. Uhler. I'd be happy to stay, Mr. Chairman.

Senator Mack. You can stay right there if you'd like to.

Mr. Uhler. I think Dr. Friedman will speak for himself.

Senator Mack. All right. Do as you wish.

At this time, we want to welcome Dr. Friedman, and I'm assuming that -- yes, your picture has come up on the screen. We're delighted that you're with us. If you would allow me to make an introduction.

Dr. Milton Friedman won his Nobel Prize in 1976 for excellence in economics. He is still considered the leader of the Chicago school of monetary economics, stressing the importance of the quantity of money as an instrument of government policy and as a determinant of business cycles and inflation.

His list of published works, including *Free to Choose*, is too long to mention here and his contributions to public policy are just as numerous.

Most of those contributions have a primary emphasis on the preservation and the extension of individual freedom. He has a BA from Rutgers, an MA from the University of Chicago, and a Ph.D from Columbia.

He has advised presidents and candidates back to Barry Goldwater, and he comes to us today as perhaps the first interactive video witness to ever appear before the Senate.

Dr. Friedman, it is a true pleasure for us to have you with us today via the satellite, via the television. I clearly understood from our conversations on the telephone why you couldn't be here in person. But, again, we're delighted

that you're with us, and if you would go ahead and make your opening statement.

PANEL IV

STATEMENT OF MILTON FRIEDMAN, ECONOMIST

Mr. Friedman. Senator, I am delighted to be with you. I am delighted that the miracle of interactive TV enables me to be with the Committee when I could not be there physically.

The problem of the deficit is that the deficit is a hidden form of taxation. It's something that people pay, but they don't realize that they're paying.

The real problem, the basic problem is not the deficit. The basic problem is government spending.

At the moment, spending by Federal, state and local governments absorbs 43 percent of the national income. In addition, the various mandates the government has imposed on individuals undoubtedly account for enough to raise our total to over 50 percent.

So over 50 percent of our national income is being spent indirectly by you people in Washington and the people in the states and local communities.

There would be nothing wrong with that if we were getting our money's worth. But is there anybody in this country who thinks we're getting our money's worth? I doubt it.

So the fundamental problem is how do we get cut spending?

I believe that the only way to keep spending down is to cut the allowance, the way we handle our children. We give them an allowance and we don't let them spend more than that.

In a very real sense, the Congress, the state and local governments are supposed to be like our children -- servants. Let me put that differently. We're not supposed to be their wards. They're not supposed to be able to tell us how we conduct our private lives. Their purpose is to do those things that people cannot do for themselves.

Many of the things that we are spending money on are things that the public-at-large gets no benefit whatsoever from, rather, harm.

For example, such expenditures as agricultural subsidies, as the case of Federal agencies enjoyed in imposing restrictions on foreign trade. I personally am in favor of abolishing the subsidy for Public Broadcasting, which is really a subsidy paid by the relatively poor to benefit the relatively well off.

One can go through the budget and find many programs that should be eliminated. But history has shown us that under the present arrangements,

government will spend whatever the tax system will raise, plus as much more as they think they can get away with.

The only way to stop that is by making it hard to raise taxes. That's why, in my opinion, a balanced budget amendment must contain a tax limitation provision, such as the super-majority requirement for a tax increase.

If it does not, I believe it will not be effective.

I should be delighted to answer questions on anything at all, but I just wanted to make a broad initial statement.

Senator Mack. Well, again, we appreciate your statement. We welcome you.

You might want to expand a little bit as you understand -- I don't know whether you heard a little earlier some of the discussion here. And I understand you don't see us, so I would say to my colleagues, when you raise a question, it would be helpful if you would state who you are.

Mr. Friedman. Yes.

Senator Mack. Let me ask this question. Again, this is Senator Mack.

Mr. Friedman. Yes, Senator Mack.

Senator Mack. There has been all through this discussion this morning the impression that somehow or another, if we were to cut Federal spending -- and I guess I would make the statement that we ought to use terms that people really understand because most of the numbers I have looked at would indicate that spending would increase slightly over the next seven years, that there wouldn't be a cut in Federal spending. We would be slowing down the rate of growth in Federal spending.

But do you see any reason why we should conclude that that's going to be to the detriment of the economy?

Mr. Friedman. On the contrary. I heard you talk about fiscal drag. Let me put that in historical perspective.

At the end of World War II, people who have the same theory as whoever it was who was talking about fiscal drag -- I didn't get his name -- were saying that the United States was facing a major depression.

Why? Because the economy had been driven by wartime spending and spending was due to come down. It did come down very drastically, as you all know.

Did we have a depression? Not at all. We had a period of relative prosperity.

It's utterly false to suppose that a reduction in government spending and a reduction of taxes, is in any way bad for the economy.

The basic level of activity in the economy depends on the people who run it, on the prime movers. We have had an enormous increase in our well-being, in our physical well-being, in the amount of output we produce, in the past 50 years.

Where has that come from?

It has come from the private sector. And what's been happening over that period? The fraction of the national income controlled by the private sector has been going down and the fraction of the income controlled by the government sector has been going up. Yet, government programs have, on the whole not achieved their objectives and the private ones have.

We have been stuffing the unsuccessful part of our economy and starving the successful part.

If you let the private economy spend a larger fraction of the national income, we're going to have prosperity, not fiscal drag.

Senator Mack. Thank you. At this point, I would turn to Congressman Saxton, and then I will go to Senator Bennett.

Representative Saxton. Dr. Friedman, thank you for being with us, albeit by satellite. It is a unique experience for all of us.

Let me pick up on something that you referred to earlier in terms of limiting the allowance that we give ourselves as being the primary way that we should go about giving ourselves the discipline necessary to balance the budget.

I support very strongly the three-fifths provision in Joe Barton's proposed Amendment. In being part of the WHIP organization, we're counting votes here and we think that we can get to within five or six of all of the Republicans on our side of the aisle to vote for the Barton Amendment next week.

That leaves us somewhere between 65, 67 votes short, and we have to go to our friends on the other side of the aisle to get those 65 or 67 votes. And I hope that we're able to do that. I don't know that we are. We may come close and we may succeed.

We don't know.

Last night, I met with the Chairman of the Rules Committee, Mr. Solomon, and we discussed yet another approach. And let me suggest this to you just for your comments.

What if we were to amend the Constitution to put a cap on spending? And there are some formulas that we can talk about. How do you do that? Some folks -- Larry Craig, I think, talked earlier, or Rod Grams talked earlier about limiting it to 19 percent of GDP, and there are other ways to get there.

What do you think of that general approach? Will that work in the same sense as a super-majority vote on tax increases?

Mr. Friedman. Unless you need a super-majority vote to have tax increases, I doubt very much that that would be successful.

But more important, I do not favor any amendment that specifies a percentage like 19 percent. Nineteen percent is too high. Over the course of time, we ought to have an amendment that enables you to ratchet down total spending so that it becomes less than 19 percent.

More important, what happens if you have major changes in programs such as social security? For example, in my opinion, the way to handle the major social security problem is to privatize it, to enable individuals to have their private accounts, something that has been done with great success in Chile and in a number of other countries.

If you did that, suddenly, a substantial part of the government expenditures would be no longer there, and the 19 percent would be obsolete.

So while I share the view that basic problem is to limit spending, I believe the most effective way to limit spending is to limit the amount of money you have to spend.

Representative Saxton. Thank you, Dr. Friedman.

Senator Mack. Senator Bennett?

Senator Bennett. Dr. Friedman, this is Bob Bennett from Utah.

Mr. Friedman. Yes, sir.

Senator Bennett. In recent years, we've heard testimony, and I agree with it, that in fact we're never going to get this thing under control until we have the courage to deal with entitlements.

If you look at the numbers that are available to us in the charts, *et cetera*, and the kinds of cuts some people are getting excited about constitute what I call budget dust. That is, they are so small, that they get lost in the turning of the pages.

You add up Medicaid, Medicare, and social security and put them in the totals and obviously, they dwarf everything else. They dwarf defense. They dwarf interest on the debt. They certainly dwarf all other discretionary spending.

You've already given us your solution to the social security dilemma. I'd like to have you talk about entitlements in general, and I'd also like to have you talk about the economic impact of the entitlements because the implication in the phrase, government spending, is that you are taking money

out of the private economy, spending it for, let us say, a battleship, which has no economic value whatsoever.

Entitlements are, in fact, transfer payments. You are taking things from one person in the economy and with a higher overhead than perhaps you want to charge, you're putting them back in the economy in the hands of someone else who will spend that as income.

The widow that we all like to think about when we're talking about social security, as opposed to the billionaire who draws social security just by virtue of his age. But the widow is living on the social security and that payment for her is income. In the overall stream, she's not getting income from a job. She's not getting income from a T-bill or a CD. She's getting income from social security.

Can you address this whole issue of entitlements and the fiscal impact of the transfer payments and where that becomes a drag on the economy, as opposed to a stimulus? Just that whole area, can you address with some enlightenment for us?

Mr. Friedman. You've raised a very broad issue and I don't believe I can cover it all. But let me make a few comments.

First, the question is whom you take it from and whom you give it to.

And second, what effect does taking from A and giving to B have on A's willingness to work, to invest, to produce. And how much overhead, as you properly mentioned, is in the process.

On the whole, the purposes of most of the entitlements are very good. They are things we all agree with. We'd like to get rid of poverty. We'd like to help people in trouble.

But if you look at the actual transfer programs, they haven't done that. You've heard over and over again how much money we have spent over the past 20 years on poverty programs and yet, measured poverty tends to grow.

Why? It's not because the money hasn't been spent. It's not because the people who receive it don't spend it. But it's because it's a very inefficient process of achieving what you want to achieve.

As in the case of social security. So also in the case of Medicare and Medicaid. I believe the key to having an efficient transfer program is to privatize it, to handle it in such a way as to give the individuals control over their own lives, rather than having outside people run it for them.

Of all the money that is being spent, for example, on poverty programs, a very considerable fraction is absorbed by overhead. It is not going to people who are poor.

The same thing is true of people on Medicare. I'm a recipient of Medicare. I'm a beneficiary of Medicare. And I am getting much more than I pay for. But I'm not getting it in an efficient form. I would rather have control myself over my expenditures on medicine.

While the talk is that the transfer payments are to help the poor, the fact is that most transfer programs go to people who are by no means poor. Most of the money that we spend on these entitlements do not go to people who are poor.

If it did, they would all be above the average income.

Senator Bennett. I understand that.

Mr. Friedman. And I want to emphasize the effect on the willingness of people to work, to invest, and so on, imposed by raising the funds.

To raise a dollar of taxes costs more than a dollar to the people involved.

Senator Bennett. I understand that. You have gone just slightly to the side of my question, and maybe I didn't ask it carefully.

I agree completely that the poverty programs have only enriched the administrators of poverty agencies and consultants who sell their services advising the administrators on those agencies and have done little or nothing to alleviate poverty.

It seems to me, however, that on the transfer payment side, we have got to consider means-testing. Now you tell us that you are drawing Medicare. You are drawing social security.

I don't mean to insult you, sir, but you don't need those things.

Mr. Friedman. I agree with you.

Senator Bennett. And means-testing becomes a method of dealing with this issue and still allowing some kind of help for the people who do in fact need it and who might not be able to solve their problem with a privatized circumstance.

Would you address that?

Mr. Friedman. I agree completely with what you say. Thirty-some years ago, in a book called *Capitalism and Freedom*, I proposed that we substitute a simple negative income tax for the whole collection of welfare programs that we now have.

A negative income tax is an arrangement under which people who are below a certain income receive a fraction of the difference between that income and their actual income as a subsidy from the government. Just as people who are above it pay a fraction to the government as a tax.

All government assistance would come straight in the form of money, not in the form of in-kind assistance. Not in the form of food stamps. Not in the form of rent subsidies and the like. And without the intervening welfare workers who now participate so importantly.

And so I agree completely with the basic idea of what you say. The problem is one of political feasibility.

About 15 years ago, I engaged in a debate in social security with Wilbur Cohen, who was at that time the head of the Social Security Administration, on social security, in which I made the proposal then that I am making here. And I argued that social security, as it was then constituted, was transferring income from relatively low-income people to the middle income and higher.

Wilbur Cohen agreed. But he went on to say that we have to make it general because a program for the poor will be a poor program and will not get passed by Congress.

It's a political problem that you people face rather than the economic problem that dictates the absence of a means test.

Senator Mack. Congressman Thornberry?

Representative Thornberry. Thank you. Dr. Friedman, this is Mac Thornberry from Texas.

I read in the paper this morning that approximately 71 percent of the American people favor a balanced budget amendment. But about the same percentage think that if it passes, the Congress is probably not going to abide by it.

I would ask you to comment generally on the importance of confidence in the government's ability to be fiscally responsible. And if we do pass a constitutional amendment, preferably with the three-fifths requirement, what effect do you think that will have on confidence and on key economic indicators, such as savings and investment and unemployment?

Mr. Friedman. What will have the effect will be carrying out the amendment rather than simply passing it.

So far as the three-fifths requirement is concerned, let me say that so far as I am concerned, I would prefer not to have any balanced budget amendment rather than one which did not contain a tax limitation provision or some other equivalent to it.

To go back to your question, that if a balanced budget amendment is passed that does not have a tax limitation provision, it will probably not work and therefore, the public would be right to be skeptical.

On the other hand, if it has a tax limitation provision, I think the chances are very good that it will have an effect. But so far as people are concerned,

and the economy is concerned, it's the actual achievement of the intended results rather than stating that you're going to do it, that will be effective.

Senator Mack. Senator Grams?

Senator Grams. Thank you very much.

Dr. Friedman, Rod Grams from Minnesota.

Mr. Friedman. Glad to meet you.

Senator Grams. It's a real pleasure to be here.

We're talking about a drag on the economy if the Federal Government isn't busy taxing and spending our money. As a Republican philosophy, we've been talking about shifting some of these programs from the Federal to the state and local government levels, such as welfare, as one of the reform packages that we're talking about, of moving that responsibility from the Federal Government down to the state.

My question to you is when we're talking about this, a lot of the talk in Washington has been to provide block grants to the states in order to pay for this.

So, in other words, we're still putting Washington in charge of collecting the taxes and then turning around and being benevolent Big Brother and deciding how much each state was going to get.

Now that might work in the short run, but what in the long term if the Federal Government would decide again to start imposing new mandates or ties or strings to this? Would it be a better restructuring to say we should reduce the Federal tax and let the state and local governments have their own revenue sources, that if they choose to fund certain programs, that then if we reduce the Federal tax burden on individuals, they would have some resources and come claim to raise state or local taxes to do the programs that the local people want done.

So when we're talking about this, should we be talking and restructuring this tax system as well?

Mr. Friedman. I agree with you. It would be far better for the Federal Government to collect less and turn over less to the states and local governments.

In general, the general principle is that the lower the level, the better. Have as much done by individuals as is possible, as much done by the local governments, rather by the state governments, than by the Federal Government.

Many of our problems today arise from over-centralization. One good example is our educational system, which is in a terrible state. It never was

a Federal responsibility. It was a local responsibility. But we've increasingly centralized it.

I noticed the other day that in 1955, there were 55,000 school districts. Now I believe there are eleven. And that's shifted responsibility from the local community to the state and from the state to the Federal community.

We ought to be moving in the other direction. I agree with you completely.

Senator Grams. Thank you.

Senator Mack. Senator Craig?

Senator Craig. Dr. Friedman, it's great to have you back with us. I've had the privilege over the years of working with you on this issue and with Lew Uhler and others.

While I prefer a tax limitation amendment, and you've not only said you preferred one. You would not prefer anything but that.

One of the concerns I have is the past record of Congress, and you know that as well as I, and that's why we're here today. But also, it appears, at least at this moment, that it will be very difficult to pass a balanced budget amendment even in this new Congress with a tax limitation because the Balanced Budget Amendment, as we know, by a three-fifths vote, is uniquely bi-partisan. It must have both Democrats and Republicans. And therefore, both parties have to come to an agreement.

In the past several years, we have arrived at an agreement that produced a balanced budget amendment with three-fifths for debt ceiling increase estimates and a constitutional majority.

Now, having said that, at this very moment, both House and Senate Budget Committees are meeting and they are using the year 2002 as their target to project their spending reductions and the budget of our government.

In other words, the anticipation of the passage of a balanced budget amendment, not a tax limitation, nor the constitutional majority that is in the one that I'm currently supporting, but the fact that we might have one that would cause the Federal budget to be in balance by the year 2002, is already driving the budget process.

It is my concern that as we pursue the art of the perfect, we miss the opportunity of the possible, that we knock the train off the track that is there already beginning to do the very thing we want to happen. Because I believe that if we do not pass a balanced budget amendment in this Congress, of either of the two that I talked about, that the opportunity to carry forth what we are currently attempting to do will be stopped almost immediately.

Your reaction to that.

Mr. Friedman. I don't fully agree. I believe that there's not a particular day on which the Balanced Budget Amendment has to be passed. I believe that so far as the public-at-large is concerned, it would strongly support a three-fifths requirement for increased taxes.

So that if you're going to do the public's will, you'd better just stand strong. Stick to your guns. Keep the three-fifths restriction on taxes. And if at first you don't succeed, try, try again.

The failure to pass a balanced budget amendment will produce a very adverse reaction in the public-at-large and may very well cause some members of Congress to change their views.

So I don't believe it's hopeless in the present circumstances to get a truly tough Balanced Budget Amendment.

A constitutional majority is certainly preferable to a simple majority of those present and voting. But a three-fifths majority is a much stronger barrier to unnecessary increases in taxes.

Senator Craig. Mr. Chairman, Dr. Friedman, while you and I and others have been working on this, at least myself for a decade, and you for considerably longer, as we've pursued the perfect, we've increased the debt by nearly \$3.5 trillion. We've now got interest on debt at \$300 billion annualized.

If interest rates were to go up another five points, it would be the first largest item in the Federal budget.

I'm not sure I'm willing to wait much longer if I have an opportunity to put before the American people a balanced budget that many of us think will create the discipline necessary.

Mr. Friedman. You may be right, but I do not believe so, because there has been a drastic change in public opinion.

After all, the political situation is not what it was when we were all trying to get a balanced budget amendment through earlier. In 1982, as you know, the Senate passed by a two-thirds vote a very good, a very strong, Balanced Budget Amendment. It got a majority of the votes in the House at that time, but not a two-thirds majority.

In the interim, the control of Congress has been largely in the hands of a philosophy that regards government spending as a good thing, not a bad thing, that is not concerned about the deficit, but rather, regards deficits as an appropriate tool of fiscal policy.

So the circumstances are different. I believe the situation today is one in which the public-at-large will strongly back a tough Balanced Budget Amendment.

Senator Craig. Thank you.

Senator Mack. Dr. Friedman, this is Senator Mack again.

Mr. Friedman. Yes, sir.

Senator Mack. I'm probably going to make a statement and then ask a question.

Mr. Friedman. Sure.

Senator Mack. It has to do with this Tax Limitation Provision, which I wholeheartedly support. I believe those who make an argument that it shouldn't be done really have put forward a false argument or a hollow argument.

It's basically the same group of people who passed legislation a few years ago requiring 60 votes to cut taxes. I really think that those who supported that and who now say that they're in opposition to a tax limitation, really need to step forward and defend what seems to be a point that is indefensible, frankly.

The question that I want to move to is, I'm particularly interested in how you see the role of government in the future.

Every day points out new examples of the government's inability to keep up with the dynamic changes in the American economy.

Do you think a balanced budget amendment will help focus the government to limit itself to more appropriate roles in the 21st Century?

Mr. Friedman. I don't think it alone will do it, but I think it's part of the change in political attitudes and philosophy which will stress reducing the size of government, giving people more power, empowering individuals.

As to the basic functions of government, they're very simple. The basic functions of government are to defend the country, protect individuals from violence and from violation of their rights by their fellow citizens, provide a judicial system which will enable people to resolve their disputes, and specify the rules under which they're going to operate.

Most of the rest is not provided for in the Constitution and is not necessary or desirable for government to do.

Now I may say that the range of tasks I've indicated would mean that the total spending on government -- Federal, state and local -- should be around 10 to 15 percent of the national income, rather than nearly 50 percent, as it is now.

So my idea of an ideal government would be an enormous change from what you have now.

Inertia will guarantee that that will not happen. However, there is now enough political recognition that government is not an effective way to achieve personal objectives. That I think there is a chance of moving in that direction.

May I comment on one other point? There's a lot of talk about responsibility. The question is responsible to whom?

Members of Congress have been very responsible. But they've been responsible to their own local constituents, not to the broader national interest. One of the functions that a balanced budget amendment can serve is to provide representatives with the means of being more fiscally and otherwise responsible, by providing them with a reason why they can't do what their constituents want.

It's very hard when somebody comes up to you with what is absolutely an admirable program that's going to help some people who need help to say, no, I can't support that.

It helps a lot if you say, I would like to support that, but this constitutional amendment requires me to balance the budget. I only have a limited budget, so I can't really make it for that particular program.

Senator Mack. I have one more question I'd like to raise before I turn it over to Congressman Saxton.

Mr. Friedman. Yes, sir.

Senator Mack. And it really kind of goes back to the discussion that has taken place with respect to the tax limitation aspects of it, and if we can't pass that amendment with the tax limitations, is there some other way that we can legislatively attempt to deal with the issue of guaranteeing, as best we can, that the reductions are on the spending side, as opposed to the tax side?

And what I'm referring to is the possibility that we end up with an amendment without the tax limitation, but with separate legislation that would require the establishment of a spending reduction commission whose role it would be to identify specific spending cuts and the Congress would have to vote up or down if those cuts weren't made in a normal process.

Your reaction to that.

Mr. Friedman. That is an approach that was tried for military bases, Representative Arney's Commission. And it worked pretty well for that.

But I don't believe that it's an alternative to tax limitation. History has shown that legislative measures toward this end have generally not been effective. You need something stronger, and a constitutional amendment requiring a three-fifths vote to vote taxes would be much stronger.

Senator Mack. All right. Well, thank you.

Congressman Saxton?

Representative Saxton. Dr. Friedman, this is Congressman Saxton again.

During this debate, there has been a discussion about two terms that are relatively new. I suppose they're not new terms, but they've been used a lot in a new sense. And those terms are balancing up or balancing down.

And by balancing up, we have referred to generally those of us who support the three-fifths provision. Balancing up means that we would, in all likelihood, raise taxes in order to bring revenues in line with outlays.

Balancing down, on the other hand, would mean that we would likely cut expenditures in order to bring revenues in line with outlays.

You said something recently that I thought was kind of interesting. You said that you would rather have the Federal Government spend a trillion dollars a year and continue to run a \$200 billion annual deficit, rather than to have a balanced budget at an annual expenditure of \$2 trillion.

Would you elaborate on that and tell us why you said that?

Mr. Friedman. I'd be glad to. The real cost to government of the American people is not what's reported as taxes. It's what the government spends.

If there's a \$6 trillion economy and government spends \$3 trillion of that, there's only \$3 trillion left for other people to spend. If the Federal Government spends \$2 trillion, there's only \$4 trillion left for state and local governments, as well as private individuals to spend.

Making that statement, I didn't say anything about how the government spending was paid for, whether by what are called taxes, by inflation, or by borrowing.

Fundamentally, the cost to the people is the same regardless of how the funds are raised. How the funds are raised is tremendously important for other things, like what happens to interest rates, the distribution of the cost and so on. But it does not affect the total cost of government to people.

If the Federal Government spent \$1 trillion rather than \$2 trillion, that would mean that state and local governments and private people would have a trillion more to spend.

Under those circumstances, the \$200 billion deficit would not be a major problem because private savings, private funds would be available to finance it.

So we need to keep eye on the real problem, which is that government is spending too much. We are not getting our money's worth for what government is spending.

Much of it is doing harm rather than good.

Polls that ask the public-at-large about spending are too broad to reveal the many activities that the government is engaged in that the public-at-large does not want to spend its money on.

I doubt very much that the public-at-large likes the idea of paying taxes to provide subsidies to farmers, at the same time that those subsidies make food prices higher.

I doubt very much that there's a general consensus around the country that you should have a limit on the imports of sugar, so as to make sugar in the United States three or four times as expensive as it is around the rest of the world.

I doubt very much that the public-at-large favors subsidizing certain industries through The Export-Import Bank, through the host of special agencies that have been established.

One of the most desirable things for the economy is to have a stable, predictable tax system. Why do we have tax changes every two or three years or more frequently?

There's no doubt what the answer is. It's because members of Congress need to raise funds to run for office. And one of the best sources of funds is from lobbyists for one tax measure or another.

And so we have the experience that we have repeated changes in tax measures with loopholes introduced, loopholes withdrawn, loopholes introduced.

That is not something that the public-at-large favors.

We need a more sophisticated analysis of the case before we decide that there's really great public opposition to cutting some of this spending.

Representative Saxton. Another reason, I guess you're saying, to make it more, it is a good idea to make it more difficult to increase taxes.

Mr. Friedman. Absolutely. Absolutely.

Representative Saxton. Also, would you care to comment on the concept while we're discussing taxes of the flat tax, as Dick Armey has so artfully suggested?

Mr. Friedman. I have a vested interest because I first proposed the flat tax in a book that I published in 1962.

I am strongly in favor of a flat tax.

Representative Saxton. Thank you.

Senator Mack. Congressman Thornberry?

Representative Thornberry. Thank you.

Dr. Friedman, this is Mac Thornberry again. In following up on a point that you just made or were discussing with Congressman Saxton, it seems to me that the debate over a balanced budget amendment, on unfunded mandates, possibly abolishing whole departments, is raising some of the same issues and same questions that were raised at the founding of this country.

And the question I want to ask from an economic standpoint is does it matter whether the money is spent at the Federal versus the state or local level?

Are the economic effects any different?

Mr. Friedman. I'm not sure what you mean by economic effects. It's very different because what is spent at the state and local level is closer to the people who are going to pay for it and who are going to realize its benefits. And it's more likely to be spent wisely.

The people in Washington ought to concentrate as the Founding Fathers intended on broad national interests, not on local, state interests.

Representative Thornberry. And would you agree that to the extent that we can push some of these functions down to the state and local level, we have a better chance of limiting overall spending of government because people can go to their courthouse or their state capitals and make reductions or make improvements?

Mr. Friedman. There is no doubt. In 1929, total spending, Federal, state and local, was about 10 to 12 percent of the national income. And two-thirds of that was state and local.

Today, total spending is closer to 43 percent of the national income and two-thirds of that is Federal.

There is no doubt in my mind at all that the growing centralization of power in the Federal Government, the growing shift of funds from local to Federal Government, has been a major factor underlying the great expansion in spending.

Representative Thornberry. Thank you.

Senator Mack. Senator Grams?

Senator Grams. Yes, Dr. Friedman. Senator Rod Grams again from Minnesota.

Mr. Friedman. Yes.

Senator Grams. Just a quick comment. When you mentioned something about needs some long-term tax policies in this country. And I've talked to many business leaders in my home state of Minnesota and they have said that this is one of the most crucial things.

We can talk about balancing the budget and many other things. But when it comes time for individuals to make tax investments or businesses to do investments for the future, and many have said that the 1986 Tax Code changes lent a lot to the savings and loan crisis, turning many good loans into bad loads because of new regulations in the tax laws.

But would you say that a prime element outside of the balanced budget that we're talking about here and other things would be to put into place something like some of the foreign centrists, like Japan and Germany might have, of a longer term base, so as an investor or an individual, that you knew when you put money into a business or a project or a savings account, you could guarantee or have reliability in those tax codes or laws not changing until you -- it really relieves you from having to go from quarterly profits to more long-term ranges for business.

Would that be reasonable?

Mr. Friedman. Unquestionably it would be a major improvement to have tax laws that stayed the same for long periods of time. They shouldn't be changed more than once every 10 years, let's say.

But in order to do that, it ought also to be a much simpler tax law. That's the great virtue of Dick Arney's flat tax.

Our present income tax is incomprehensible, anyway. There's nobody who understands it. And it would be a major advantage to replace it by a simple flat tax of the kind that Dick Arney has been proposing.

And that should stay the same.

One of the advantages of a flat tax like that is that changes could take the form solely of changes in the rate and not the base. He's proposing, I believe, a 19 percent rate?

Senator Mack. I think it's 17.

Mr. Friedman. I believe that if fiscal policy proceeded as it would be desirable to have it proceed, that rate could be lowered from 19 to 18 to 17 to 16, but you could leave the fundamental structure unchanged.

Senator Grams. Thank you very much.

Senator Mack. Senator Mack again.

I want to raise a question that I actually raised earlier with some of the other panelists. But I think it's an important one to get your response to.

Many critics of the Balanced Budget Amendment have argued that a balanced budget rule restricts the ability of government to respond to economic emergencies such as a recession.

Doesn't this reasoning imply that government has the ability to fine-tune the economy? Do you believe fine-tuning is possible? And the last, almost a kind of editorial comment -- are Keynesian ideas dead?

Mr. Friedman. Keynesian ideas, in one sense, are dead and in another sense, are as alive as they ever were.

They're dead in the sense of being part of the mainstream economics, of the scientific discipline. But they are alive in practice.

Over and over again, people will say, the government has to spend money to get us out of the recession. They have to fine-tune.

Such statistical analyses as I have been able to do in the past suggests that fine-tuning doesn't work, that in fact, government fiscal movements have made the economy less stable rather than more stable.

Let me give you one striking figure.

Average unemployment from 1900 to 1930 was less than in the 30 years after the passage of the Full Employment Act.

Monetary policy is a much better instrument for providing a stable background for economic activity than fiscal policy.

There are long lags before a problem is recognized, before something is done about it, and before what's done has its effect. What starts out to offset a recession often turns out to speed up a subsequent recovery.

So, on the whole, I believe that fine-tuning is a bad idea. Neither fiscal nor monetary policy should be used for fine-tuning. Both should be used for long-run objectives and kept highly stable.

Senator Mack. Well, I thank you for that comment.

Representative Saxton. Dr. Friedman, this is Jim Saxton again.

Mr. Friedman. Yes.

Representative Saxton. Would you care to comment further on -- we're not here really to talk about monetary policy, but it is something that we're going to, that Senator Mack and I are very interested in, and are looking at the possibility of legislation with regard to the Fed role.

Would you comment further in a general sense as to what you think the role of the Fed ought to be? And are there changes needed that we should look at legislatively?

Mr. Friedman. Yes, I believe that there are. The role of the Fed should be very simple -- to stabilize the price level, prevent inflation.

The most effective way in which Congress could at the moment help them do that would be by providing for the issuance of purchasing power securities, government debt that is adjusted for changes in the cost of living.

That is that the market would then enable you to get day-by-day estimates of inflationary expectations on the part of the public.

Suppose we would have two matching obligations, one expressed in nominal dollar terms, the other expressed adjusted for inflation. The difference between the yields on those two debt instruments would be a measure of the inflationary expectations on the part of the public.

Congress would do well to enact that the Fed is required to keep at inflationary expectation within, let's say, 0 to 3 percent, and if it gets outside that range, every member of the Board has his salary reduced by a quarter.

(Laughter.)

Senator Mack. I like your suggestion.

Mr. Friedman. You need to have a sanction if it's going to be effective.

Senator Mack. I thank you for your suggestion. I think we're down to about a minute. So let me just close by saying how much we really appreciate your thoughts and your input.

We probably will ask you to do this again when we get into some discussions about monetary policy. But your thoughts have been very, very effective today. And again, I thank you.

And if you would be kind enough to pass on our good wishes to Rose Friedman, who has been at your side working on economic matters with as much conviction as you.

So we're delighted that you had the opportunity to be with us.

Thank you.

Mr. Friedman. Well, thank you very much. I'm delighted to have had this opportunity to speak to my friends in Congress at long distance.

Senator Mack. Thank you.

The meeting is concluded.

(Whereupon, at 1:00 p.m., the hearing was adjourned.)

SUBMISSIONS FOR THE RECORD

**PREPARED OPENING STATEMENT OF REPRESENTATIVE
PETE STARK, RANKING MINORITY MEMBER**

Good morning. I want to begin by commending Senator Mack for holding these hearings. The Joint Economic Committee provides a valuable forum for debating economic policy. It is the place where the broad outlines of sensible economic policies should be developed and the place where economic follies should be exposed.

Unfortunately, the balanced budget amendment falls into the latter category. Last week, Al Hunt wrote an interesting piece on the Balanced Budget Amendment in the Wall Street Journal. He pointed out the inconsistency of those who tout the "Contract with America" as giving the American people a detailed agenda but who also refuse to provide details of how they would balance the budget before passing a balanced budget amendment to the Constitution. In a similar vein, I have offered to give \$2,000 to the charity of choice of any Republican Member who can explain in detail how they would balance the budget in fiscal year 1996 while also increasing defense spending and cutting taxes.

There are a number of reasons why we should not pass a balanced budget amendment. First, the Constitution--adopted as a timeless framework for addressing fundamental that addresses a problem that arose from a bout of temporary fiscal insanity in the 1980s. President Clinton and the Democrats who voted for the 1993 deficit reduction agreement showed that it is fully within our power as legislators to bring the deficit down in a responsible way without wrecking the economy and without dismantling the many worthwhile government programs that enjoy wide popular support. Balanced budget amendment proposals, by contrast, offer vague promises and dangerous prospects. Many analysts -- Republicans and Democrats -- have warned that such an amendment would cause needless confusion, evasion, and litigation.

Besides these concerns, which by themselves ought to be enough to convince responsible people that a balanced budget amendment is a bad idea, there are strong economic reasons for rejecting rigid formulas for balancing the budget.

A balanced budget amendment would be a great way to turn the next recession into a rip-roaring depression. This is because it would undermine

the use of automatic stabilizers, which have been one of the great successes of economic policy during the post war period. Automatic stabilizers like unemployment insurance help support incomes and spending when the economy weakens--without any Congressional action. The tax increases or spending cuts required by a balanced budget amendment would substitute a longer and deeper recession for the temporary deficits associated with the mitigating effects of automatic stabilizers. Have the proponents of a balanced budget amendment asked the American people whether they are willing to pay the price of longer and deeper recessions, with massive unemployment, in order to always keep the budget in balance?

Finally, I want to point out that no other nation in the world imposes a balanced budget requirement on its national government. They recognize that other government responsibilities can be more important than keeping the budget in balance each and every year. In the United States, state and local governments operated under various kinds of balanced budget requirements. But none is so stringent or inflexible as the current proposals before us.

Don't get me wrong. We have a budget deficit problem that we need to continue to address in a responsible manner over the next several years. But no proponent of a balanced budget amendment has met my challenge to lay out the specifics. If recent press reports are accurate, my Republican colleagues appear to be backing away from such specifics during their first 100 days because if we knew them, "our knees would buckle."

Thank you, Mr. Chairman. I look forward to what we will learn in these hearings.

PREPARED STATEMENT OF SENATOR JON KYL

Mr. Chairman, I appreciate this opportunity to appear before the Committee today to discuss the Balanced Budget Amendment and, specifically, whether or not to include an explicit limitation in the amendment on taxes or spending.

A balanced budget amendment should, in my view, accomplish two things: first, it should promote fiscal responsibility; and second and perhaps equally important, it should promote policies that foster economic growth and opportunity.

A balanced budget amendment without a spending or tax limitation would force Congress to be more responsible in its budgeting practices. But, there is more to responsible budgeting than *just* balancing the nation's books. It also matters at *what level* Congress blanks its books relative to the size of the nation's economy. Gross national product now exceeds \$6 trillion; but, as economist Walter Williams pointed out in a column last year, few would be happy if federal expenditures were \$6 trillion and federal tax revenues were \$6 trillion.

Gerald Scully, a Senior Fellow of the National Center for Policy Analysis and a professor of economics in the School of Management at the University at Texas at Dallas, came to similar conclusions in a report published last November. He found that:

“American productivity has faltered since the 1950s. Productivity growth rates that were in the 3.1 to 3.5 percent range have fallen below 1 percent. As a result, many Americans have suffered a decline in their living standard. Considerable evidence points to the growth in the size of government since World War II and the accompanying increase in taxes as a cause.”

Scully went on to suggest that “in order to maximize economic growth, the average rate for federal, state and local taxes combined should be between 21.5 percent and 22.9 percent of gross national product (GNP). Taxes as a share of GNP have not been in this range since 1949.”

There are two ways to get that optimum level of government Scully discussed: limit taxes, or limit federal spending. I support either approach, but believe that a spending limitation is preferable. It represents the most direct approach and the easiest to implement.

Limit taxes, and the only way to balance the budget is to cut Federal spending. Why not say so at the outset? Limit spending, and there is no need for Congress to consider tax increases. It wouldn't be allowed to spend the additional revenue.

Limiting taxes is a more difficult proposition than limiting spending. Revenues to the Treasury are subject to the vagaries of the economy. The amount of revenue is never known until a fiscal year has come and gone. On the other hand, Congress can ostensibly control how much it spends.

Nineteen states across the country have some form of spending limits, either in statute or in their constitutions. And, a federal spending limit is at the core of the Balanced Budget Spending Limitation Amendment, S.J.Res. 3, which I introduced on January 4th. My amendment would require a balanced budget and limit spending to 19 percent of GNP, which is roughly the level of revenue that the federal government has collected for the last 40 years.

By limiting spending, my amendment ensures that the budget will be balanced the way the American people want -- by cutting spending. And, by linking spending to GNP, it provides Congress with a positive incentive to promote pro-growth economic policies. Only a growing economy, measured by GNP, would increase the dollar amount that Congress is allowed to spend.

Whether or not Congress writes a federal spending limitation -- or a tax limit -- into a balanced budget amendment or subsequent implementing legislation, I would assert that Congress *will* have to deal with the effective limit on revenues, relative to GNP, which the economy has imposed.

As I noted earlier, revenues to the Treasury have fluctuated around a relatively narrow band of 18 to 20 percent of GNP for the last 40 years. That is despite tax rate increases and tax cuts, good economic times and bad, and fiscal policies pursued by presidents of both political parties.

That is because changes in the Tax Code change people's behavior. Lower taxes stimulate the economy, resulting in more taxable income and transactions, and more revenue to the Treasury. Higher taxes discourage work, production, savings and investment, so the economy grows at a slower and revenues are always less than initially projected. Although tax cuts and tax rate increases may create temporary declines and surges in revenue, revenues always adjust a roughly the same percentage of GNP as people adjust their behavior to the new Tax Code.

Since revenues remain relatively constant at about 19 percent of GNP, the significance of our nation's tax policy is whether it leads to a stronger and larger economy, measured in terms of GNP, or a smaller and weaker economy. In other words, 19 percent of a larger GNP would represent more revenue to the Treasury than 19 percent of a smaller GNP.

The 1986 Nobel Laureate in Economic Sciences, Dr. James Buchanan, put it another way:

“Reducing government as a share of GNP from its [1991] level of 25 percent to, say, 20 percent would generate roughly a two percent increase in the rate of growth of GNP. And back-of-the-envelope arithmetic suggests that by the early 2000s, and forever beyond, the real value of the programs financed by government would be larger than they would be under the regime that keeps government’s share at 25 percent.”

Limit spending to the level, relative to GNP, that the economy has historically been willing to bear and the incentive will be for Congress to enact pro-growth economic policies. Limit spending and there is no need to raise taxes. Limit spending and the real cause of big deficits is resolved.

Mr. Chairman, I believe a constitutional amendment to require a balanced budget should include a federal spending limit. However, I would also suggest that the stakes are too high, in terms of the mountain of debt we are passing on to future generations, to miss yet another opportunity to send the basic version of the amendment to the states for ratification. If the votes are not there for a spending or tax limitation amendment, then I believe Congress should adopt the basic amendment.

We can deal with the issue of spending limits, or tax limits, in the context of implementing legislation, and indeed, I believe we will. I look forward to working with the members of the Committee in that regard.

Congressman Joe Barton

Testimony in support of the
Tax-Limitation Balanced Budget Amendment

before the
Joint Economic Committee

January 20, 1995

Thank you, Mr. Chairman, for inviting me to speak. I am honored to have the chance to contribute to the public debate on what I consider the most important legislation the Congress will consider this year.

Next week, the House of Representatives will have an historic opportunity to save our children, grandchildren, and future generations of Americans from the awful burden of the Public Debt. This Committee is to be congratulated for holding hearings on this important issue so early.

As the 104th Congress began, the public debt is more than \$4.8 trillion and rising rapidly. Each American's share of our debt is more than \$18,300.

The payment of interest and debt principal takes precious dollars away from taxpayers and spending programs and, importantly, makes reducing taxes more difficult. The debt is a drain on our economy, too - it crowds out capital and impacts interest rates, artificially increasing the cost of borrowing for business purposes.

Our Nation has amassed this immense and awful debt by consistent overspending. Congress, which has the power to balance the budget, has refused to do so every year since 1969. The budgetary discipline we should be demonstrating is nowhere

evident. Clearly, that discipline must be restored - Congress must be required to balance its budgets.

Ever since I have come to Congress, I have proposed a Tax-Limitation Balanced Budget Amendment. Opinion polls show the American people strongly support my amendment, and this year, I think it will pass.

The amendment is rather simple - it requires the President to propose and Congress to submit a balanced federal budget, and erects tough barriers to prevent them from doing otherwise. It requires a sixty percent supermajority vote to "deficit spend" and borrow money. Significantly, the amendment also has a tax-limitation provision, which requires a sixty-percent supermajority vote for tax increases to balance the budget.

The tax-limitation provision is an important part of my balanced budget amendment because it raises the percentage required to raise taxes, thus making it more probable that spending will be reduced in order to balance the budget. Four of the last five major tax increases did not pass with sixty percent margins in both houses. The tax burden created by those four major tax bills is more than \$666 billion.

The growing support for tax-limitation is evident in the states. Nine states already require at least a three-fifths vote for tax increases (Arizona, Arkansas, California, Delaware, Florida, Louisiana, Mississippi, Oklahoma, and South Dakota). In November of 1994, seventy-eight percent of Nevada voters gave the first of two approvals to a two-thirds supermajority provision for their state. With another vote in 1996 in favor of the

measure, the momentum for supermajority requirements for tax increases will continue as Nevada becomes the tenth state to erect such a barrier to new or increased taxes.

The experience in the states shows that tax-limitation works to reduce taxes. From 1980 to 1987, taxpayers in states with tax-limitation provisions enjoyed a two percent decrease in the portion of personal income they paid in taxes. In the same time, however, taxpayers in states with no such protections paid an additional two percent of their personal income in taxes. In fact, in almost every year since 1980, taxes have increased more in those states without supermajority requirements than those without. I have charts graphically depicting the states' experience with tax-limitation and ask they be included in the record.

Tax-limitation curbs spending, too. The ratio of spending to personal income increased nine percent in states without tax-limitation, and only two percent in states that do have such provisions.

Support for the Tax-Limitation Balanced Budget Amendment continues to grow in the House of Representatives, as well. Even with a legislative procedure that favored other amendments and provided an excuse for voting against my amendment, Tax-Limitation Balanced Budget Amendment vote totals are increasing. Last year, a majority of the House voted for the Barton-Tauzin Tax-Limitation Balanced Budget Amendment and, on January 4, 1995, 279 members voted to require a three-fifths vote to raise income taxes in the House during the 104th Congress. That is only

eleven votes short of the two-thirds vote needed for final passage, and with strong bipartisan leadership, I predict we will pass the amendment.

When the Tax-Limitation Balanced Budget Amendment passes the House, it will head to the Senate. I believe that the overwhelming support of the American people, which helped push the tax-limitation amendment through the House, will also push it through the Senate. I was glad to hear that Senator Rod Grams will introduce the Tax-Limitation Balanced Budget Amendment in the Senate. I look forward to working with him to achieve victory in both Houses of Congress.

The Barton-Hyde-Tate Tax-Limitation Balanced Budget Amendment is supported by Milton Friedman, Nobel Laureate in Economics, William Niskanen of the Cato Institute, the National Tax-Limitation Committee, the National Federation of Independent Business (NFIB), Citizens for a Sound Economy (CSE), Citizens Against Government Waste (CAGW), and many other organizations committed to reducing government spending, balancing the budget, and restricting taxes. With your permission, I would like to include a full list in the record.

I hope the committee will see fit to endorse a balanced budget amendment with the important tax-limitation language. On the Opening Day of the 104th Congress, the House voted to make a sixty-percent supermajority requirement for tax increases part of our rules. We should do no less in our Constitutional Amendment to require a balanced budget.

I thank the Chairman for the opportunity to speak and the members of the committee for hearing me. Thank you.

**REPRESENTATIVE BARTON FOR SUBMISSION:
ORGANIZATIONS SUPPORTING THE TAX LIMITATION BALANCED
BUDGET AMENDMENT**

REASONS GRASS ROOTS AMERICA SUPPORTS

THE TAX-LIMITATION BALANCED BUDGET AMENDMENT

- Every American has an \$18,300 share of the \$4.8 trillion public debt
- Congress must be required to balance the budget
- Balancing should be done with spending cuts, not tax increases
- Force the tax-raisers to get a sixty-percent supermajority to increase taxes

American Conservative Union

American Furniture Manufacturers Association

Americans for Tax Reform

Associated Builders and Contractors

Business Round table

Chamber of Commerce of the U.S.

Christian Coalition

Citizens for a Sound Economy

Citizens Against Government Waste

Competitive Enterprise Institute

Concerned Women for America

Financial Executives Institute

Milton Friedman, Nobel Laureate in Economics

International Food Service Distributors Association

International Mass Retail Association

Jim Miller, former Director of Office of Management and Budget

National Association of Home Builders

National Association of Manufacturers

National Association of Realtors

National Association of Wholesale Distributors

National Beer Wholesalers Association

National Center for Public Policy Research

National Federation of Independent Business

National Grocers Association

National Restaurant Association

National Tax-Limitation Committee

National Taxpayers Union

National Wholesale Grocers

William Niskanen, former Chairman of Council of Economic Advisors

The Seniors Coalition

Small Business Survival Committee

United Seniors Association

Paul Weyrich, National Chairman of Coalitions for America

PREPARED OPENING STATEMENT OF REPRESENTATIVE DONALD MANZULLO

Mr. Chairman, I want to thank you for holding this hearing today. I firmly believe that a balanced budget is the best way to insure the future economic prosperity of the United States; it is a long-term solution to a long-term problem. For decades, Congress has been full of pork-barrelers and recreants who could not restrain their proclivity to spend. A balanced budget limits the powers of government and brings stability to the budget-making process.

Deficits are not a short-term trend. The Federal government has run a deficit for 56 of the last 64 years, and the last 25 years in a row. Congress has tried to change its free-spending ways, but countless "budget-deals" have not done a thing. In the 1920s, Federal spending as a percentage of GNP was three percent; in 1940 it was 10 percent; and in 1992 it was 22.4 percent. Eliminating the deficit is one of the most urgent priorities facing the country. We can't begin to tackle our near \$5 trillion national debt until the Federal budget runs a surplus. And unless we begin to repay our debt soon, this country will be headed for a deep and prolonged economic crisis.

When it comes to balancing the budget, the deficit is a convenient target for election-year attacks. But when it comes to getting reelected, deficit spending is the key. Why? First, intense pressure for spending tend to override a generalized preference for fiscal restraint and balanced budgets. In the short run, deficit spending is the most painless political option and the path of least resistance. In other words, "wasteful spending" has a curious appeal to deficit-hostile constituents when its in their own district. Second, intense pressure for spending tends to override the general, diffused targets of most tax increases. Tax increases are purposely spread out enough that they don't spark a Boston tea party. For Congress, it's easy to tax and easier to spend, making it almost impossible to balance the budget.

Mr. Chairman, a long-term, structural response is needed to reverse a long-term, structural problem. The solution is a Balanced Budget Amendment to the Constitution. I don't take this step lightly, but it's one that Thomas Jefferson endorsed. An amendment reestablishes a level playing field, forcing Congress to place higher priority on balancing the budget rather than spending and taxing. It restores the Constitution's goal of limited government.

Some critics of this legislation contend that it will unfairly impact Social Security. Nothing could be further from the truth. These critics say that

Social Security is not part of the deficit problem. I agree completely. Social Security is soundly financed and runs a surplus every year. However, a constitutional amendment to require a balanced budget does not change Social Security in any way.

Current laws on the books that protect Social Security would not be changed by the amendment. For example, Social Security is exempt from across-the-board budget cuts. The trust fund is already excluded from deficit calculations. The amendment does not change those laws in any way.

Taking Social Security, and other worthy programs, off budget under the amendment would open up a loophole to evade the intent of the proposal. It would set a precedent for other government programs to simply be taken off the books. The deficit could be "eliminated" simply by shifting enough government programs into off-budget accounts. This would only make matters worse. I'm sure you wouldn't do this with your own check book. That's why I don't want to make an exception for the government.

Mr. Chairman, since I took office, I have had the courage to vote over 159 times to cut \$137 billion in wasteful spending. Unfortunately, most of Congress did not agree. If we do not respond to our long-term problem with a long-term solution, large Federal deficits and low private savings will lead to increasingly costly and precarious dependence on foreign capital, and less investment to modernize and expand the economy. All this will result in smaller gains in productivity and a lower standard of living for our children and grandchildren. Congress must vote for the Balanced Budget Amendment to save future generations from this unconscionable economic burden.

Again, I want to thank you, Mr. Chairman, for holding this hearing and I eagerly look forward to the testimony from our fine panel of witnesses.

PREPARED STATEMENT OF SENATOR ROD GRAMS

Mr. Chairman, thank you for calling this important hearing on the impact of a balanced budget amendment which requires a super-majority vote to increase taxes.

Yesterday, I introduced just such a bill in the Senate. I am especially pleased that our distinguished Chairman, Mr. Mack, is an original co-sponsor of this legislation, and that we have been joined by the Majority Whip, Senator Lott, and our colleagues, Senators Inhofe and Thomas.

This bill is what the American people are calling for. It balances the budget...but would protect the American taxpayer from Congress and its higher taxes.

There is no question that Congress must pass a balanced budget amendment and send it to the states for ratification. For years, Washington has been racking up deficits. In the process, we've racked up a four and a half trillion national debt. And sadly, we've got very little to show for it.

If you look at every so-called "deficit reduction" package Congress has passed in the last decade, you'll find that each one follows a consistent formula. Raise taxes now. Cut spending later.

Tragically, however, once Congress raised the taxes, it always forgot about the spending cuts. So, year after year, taxes would go up, spending would go up, too. It's time to put an end to this madness.

That's why I introduced a "taxpayer protection" Balanced Budget Amendment that would require a three-fifths super-majority vote in both Houses of Congress to raise taxes. A super-majority requirement is the best way to show the American taxpayers that Congress is serious about balancing the budget through spending cuts...and not through higher taxes.

That's what I promised the taxpayers of Minnesota during my campaign for the U.S. Senate. That's what they elected me to do. That's what my bill delivers.

Is there enough support in Congress to pass it? If we listen to the folks back home, there certainly ought to be. A poll released just this week by the American Conservative Union shows that the American people overwhelmingly support the super-majority requirement. In fact, two thirds of those who already support a balanced budget amendment say that without a super-majority provision, the bill would be a sham.

The people have spoken. A balanced budget must be achieved through cuts in government spending. Americans are willing to do that...but they aren't willing to be patsies for a big-spending government that just hasn't learned when to say "no."

I look forward to the testimony of the witnesses today, and again thank you, Mr. Chair, for holding this hearing.

PREPARED STATEMENT OF WILLIAM A. NISKANEN

A proposed budget that would increase the federal debt or taxes should be approved by a broader consensus of Congress than that required for routine legislation. That is the sum and substance of the balanced budget/tax limitation amendment now before Congress.

Consistent with the letter and spirit of the Constitution, the proposed amendment defines the rules by which the major fiscal decisions would be made, not the outcomes of these decisions. The proposed amendment would not constitutionalize fiscal policy. The "automatic fiscal stabilizer" would still be effective; stronger-than-expected economic conditions would lead to a budget surplus, weaker-than-expected conditions to a budget deficit. The amendment would require broader support for an increase in debt or taxes but would not require a balanced budget or prohibit a tax increase. The primary purpose and effect of the proposed amendment would be to assure that a decision to expand the fiscal powers of the federal government reflects a broader support of Congress than that required for routine legislation.

The Case for New Fiscal Rules

For the first 140 years of U.S. history, the federal budget was effectively constrained by two fiscal rules: the formal limits in the Constitution on the enumerated spending powers and an informal rule that the government could borrow only during the recessions and wars. At the end of the 1920s, federal expenditures were 2.6 percent of GDP, most of which was for the military and the deferred costs of prior wars. And the characteristic budget surplus during peacetime recovery years constrained the federal debt to 16 percent of GDP. The constraints on federal spending and borrowing also contributed to the conditions that led to a roughly stable general price level over that long period.

Over the past six decades, however, federal expenditures have increased to about 23 percent of GDP, most of which is for new forms of services and transfer payments. Larger and more frequent budget deficits (continuous since 1969) have increased the federal debt held by the public to an amount about 50 percent of GDP. And the general price level is now about 10 times the level at the beginning of this period. This dramatic change in fiscal and monetary conditions in my lifetime occurred without one amendment to the Constitution that would authorize a change in the fiscal rules. Our effective Constitution has been transformed into one in which Congress and the president may authorize any type or amount of expenditures and taxes, subject only to the voting rule for routine legislation.

The appropriate response to this erosion of the substantive limits on federal fiscal powers is to approve more constraining voting rules on

decisions affecting the budget totals. One should reject out of hand the argument that such rules are inherently inconsistent with democratic government.

All of us are willing to delegate many decisions within a family, firm, and other voluntary organizations to realize the benefits of comparative advantage and the reduction of decision making costs. For this same reason, many nations have chosen a representative government with a majority voting rule. Such delegations, however, are almost always subject to substantive, quantitative, or procedural constraints on the group to which the decisions are delegated. Moreover, there is an important relation between the voting rule and the several types of constraints: the lower voting rule, the more important are the constraints on the authorized powers of the organization.

For governments, the realistic alternatives are to authorize a narrow range of powers and a majority voting rule or a broader range of powers and a super-majority rule. The design of the U.S. Constitution was to limit federal expenditures to the enumerated powers defined in Article 1, Section 8, with the amount of such expenditures to be determined by the normal voting rules for appropriations. There is a reasonable case that such substantive limits may be preferable to a super-majority rule on the budget totals. Such substantive limits, for example, permit a federal politician to respond to constituent pleas by saying, "I would like to help you, but the Constitution does not authorize Congress to finance this service". But that genie is already out of the bottle. Most of the current activities of the Federal Government have no constitutional basis in the enumerated powers, and there is no prospect of a constitutional consensus on the original substantive limits or on some new set of substantive limits.

The case for a new fiscal rule affecting the authority of the federal government to borrow is based on three observations. First, the current pattern of federal expenditures and receipts is not sustainable. Second, it is preferable to stabilize the ration of the federal debt (or interest payments) to GDP sooner than later, at levels of this ration closer to the present level than at a higher level; net interest payments, already the third largest component of federal expenditures, are also among the most rapidly growing components. Third, Congress has demonstrated no ability to bind itself or a subsequent Congress to a sustainable borrowing rule.

The absence of obvious near-term adverse effects of the federal deficit, however, has contributed to the erosion of the political discipline necessary to enforce a sustainable fiscal policy; if some adverse effects had been more apparent, the normal political incentives of Congress would probably have

been sufficient to reduce the growth of the federal debt. The primary problem of federal borrowing is a moral problem: we are passing an increasing part of the cost of current government services to our children--without their consent. Federal net interest payments are now about \$2,000 per taxpayer; each new generation of voters and taxpayers would clearly prefer that less borrowing had been authorized in prior years. The case for a new constitutional rule on the authority to increase the federal debt is to protect our children from our own lack of fiscal discipline.

Finally, the U.S. Constitution requires a super-majority to approve several measures. Congress has established a super-majority rule for several other types of measures, now including proposals to reduce taxes. Almost all of the states have some form of special rule on the issue of new debt. Many of the states require a super-majority of the legislature or a referendum to increase taxes. Majority rule has instrumental value--it is the minimum voting rule that avoids inconsistent decisions on the same vote--but it does not have normative value in and of itself. There is ample precedent and a strong case for requiring a higher voting rule on more important decisions like the overall levels of public debt and taxes.

Some Remaining Issues

Two remaining issues must be resolved to assure approval and ratification of an effective amendment:

- o The Senate version of the proposed amendment, which authorizes an increase taxes by a majority of the members of each house, does not provide an adequate barrier against increased taxes. This increases the prospect that the budget would be balanced by higher taxes rather than a slower growth of spending, weakens the potential economic benefits of the amendment, and reduces the prospects for ratification.
- o Neither version protects state and local governments from an increase in unfunded mandates. Congress plans to vote on a statute that provides such protection before the vote on the proposed constitutional amendment, but statutory protection that may later be changed may not be sufficient to assure ratification of the amendment.

Congress is now rushing to vote on these issues by the end of next week. If it takes more time to resolve the above issues, Congress should delay the vote. There has never been a better opportunity to restore a responsible fiscal constitution. Do it right. Seize the day!



1007 Cameron Street
Alexandria, VA 22314
(202) 547-4196

151 N. Sunrise Avenue
Suite 901
Roseville, CA 95661
(916) 786-9400
FAX (916) 786-8163

TESTIMONY OF LEWIS K. UHLER
President, National Tax Limitation Committee

BEFORE THE JOINT ECONOMIC COMMITTEE

Regarding the Tax Limitation/Balanced Budget Amendment

JANUARY 20, 1995

SUMMARY

H.J.Res 1, the Tax Limitation/Balanced Budget Amendment, properly ensures a super-majority vote for tax increases. The following changes in the wording of H.J.Res. 1 will strengthen and improve it:

- Section 2 of the 103rd Congress's H.J.Res. 9 (Barton/Tauzin) should be substituted for Section 2 of H.J.Res. 1. This would preserve the super-majority vote for tax increases and provide a limit on the growth rate of federal receipts and outlays from year to year so the federal government does not consume an increasing share of GDP. (The use of "receipts" instead of "tax revenues" should be restored.)
- Eliminate Section 3 and instead amend the Budget Act regarding presidential compliance with the Amendment.
- Eliminate the "imminent and serious military threat ..." language from the Declaration of War provision in Section 4.
- Eliminate or revise Section 6 regarding the debt limit vote;
- Eliminate Section 8 regarding Congress's implementing legislation as surplusage — and possibly harmful.
- Add a section providing states and local governments protection against federal mandates.

Mr. Chairman and Members of the Committee:

Representative Hyde and the Members of his Judiciary Committee are to be commended for reporting out of Committee a Tax Limitation/Balanced Budget Constitutional Amendment. H.J.Res. 1, which would make far-reaching improvements in the fiscal practices of the government of the United States.

In reviewing the text of H.J.Res. 1, we find that there are certain provisions which could be added, altered or eliminated which would strengthen and improve the Amendment. The source of this Amendment is the "Contract With America" Tax Limitation/Balanced Budget Amendment, which in turn was taken from the 103rd Congress's H.J.Res. 9 (Barton/Tauzin) and S.J.Res. 6 (Gramm/Dole), hereafter "H.J.Res. 9." The key operative provisions of H.J.Res. 9 were Sections 1 and 2. These sections read as follows:

"Section 1. Prior to each fiscal year, Congress shall adopt a statement of receipts and outlays for such fiscal year in which total outlays are not greater than total receipts. Congress may amend that statement provided revised outlays are not greater than revised receipts. Congress may provide in that statement for a special excess of outlays over receipts by a vote directed solely to that subject in which three-fifths of the whole number of each House of Congress agree to such excess. Congress and the President shall ensure that actual outlays do not exceed the outlays set forth in such statement.

"Section 2. Total receipts for any fiscal year set forth in the statement adopted pursuant to the first section of this Article shall not increase by a rate greater than the rate of increase in national income in the second prior fiscal year, unless a three-fifths majority of the whole number of each House of Congress shall have passed a bill directed solely to approving specific additional receipts and such bill has become law."

Together these sections are designed to produce the following results:

- federal receipts can grow no faster than the growth of the economy;
- outlays are linked to the growth of receipts, thereby producing a

specific dollar number spending limit for the fiscal year (this sets a single target for Congress each year);

- balance between actual receipts and actual outlays each year is not required; balance is achieved over the life of a business cycle;
- Congress may spend in excess of the limit only if three-fifths of the whole number of each House of Congress approve borrowing, or a tax increase, or a combination of the two;
- Congress and the President are authorized and empowered to enforce the limit by assuring that actual outlays not exceed the outlay limit.

In H.J.Res. 1, however, Section 2 of H.J.Res. 9 has been removed entirely and in its place has been substituted the following provision:

"No bill to increase tax revenue shall become law unless approved by a three-fifths majority of the whole number of each House of Congress."

The result of this change is to eliminate any control over the statement of receipts and outlays in Section 1, making Section 1 and, hence the Amendment, an "estimates" amendment only. Since there is no penalty for mis-estimation in a single year, or year after year, there is no real restraint on the receipts/outlays estimate of Congress; and because actual outlays are tied to outlays in the statement, there is no definitive control over actual outlays. Control over the growth of receipts and outlays has been abandoned, allowing the share of the economy flowing to Washington to continue to grow without restraint.

New Section 2, beyond the deficiencies noted above, is imprecise and quite possibly mischievous:

- The Judiciary Committee changed the word "receipts" to "tax revenue." "Receipts" are defined in the Amendment, but "tax revenue" is not. What does tax revenue mean for purposes of this Amendment? Does it include "contributions" to social security? Quite clearly it does not apply to fees, thereby leaving open to redefinition, outside the control of this Amendment, revenue sources which currently might be within its ambit.
- Revenues of the federal government regularly increase from year to year as a result of economic growth of the Nation. Tax law changes may or may not increase tax revenues beyond what might ordinarily be received under existing law. Hence, this provision, as written, will leave to the estimators

(presumably CBO and OMB) whether tax law changes will result in a "net" increase in tax revenue. Hence, they will determine whether a majority or a three-fifths vote is required. The only way to avoid this result would be to amend the wording of Section 2 to say "no bill to increase the rate or base of any tax shall become law ..."

- The above clarifying language in the tax increase section would do nothing to constrain the growth of federal receipts that might occur without a vote of Congress. A future Congress could well re-establish a progressive personal (and corporate) income tax rate schedule and eliminate indexing. Receipts to the federal government could expand in the same explosive way they did in the late '70s, without any tax rate increase whatsoever.

My conclusion is that H.J.Res. 1 has been rendered largely toothless by the changes made with respect to Section 2 of H.J.Res. 9. I suspect that the symmetry between and the interdependence of Sections 1 and 2 in H.J.Res. 9 were not fully appreciated by those who fashioned the Contract With America version. It is essential that such oversight be rectified by reinserting Section 2 of H.J.Res. 9, *in toto*, as a substitute for Section 2 of H.J.Res. 1.

PRESIDENT'S "BUDGET" SUBMISSION ROLE. Section 3 of H.J.Res. 1 contains the following language:

"Prior to each fiscal year, the President shall transmit to Congress a proposed statement of receipts and outlays for such fiscal year consistent with the provisions of this Article."

This language found its way into various amendment designs in about 1986-87 when Democrats wanted to embarrass Ronald Reagan into submitting a budget that was in balance. This is a kind of political "what's-good-for-the-goose-is-good-for-the-gander" provision.

Such a provision is unnecessary because the President's only duty/authority to develop or propose a budget is entirely statutory (Budget Act of '21, amended in '74). This section would add a new presidential duty to the

Constitution. Furthermore, it may give the President more authority than he currently possesses to actually shape the budget, not merely propose one that is in balance.

Even without such a provision, the President must develop his proposed budget in a manner consistent with the new constitutional rules on receipts and outlays. If he did not, he would be a political laughing stock. Political reality would drive the process. If any refinement is necessary or desirable it can be accomplished by statutory means -- by amending the Budget Act.

WAR-TIME EXCEPTION. H.J.Res. 9 included an exception for any fiscal year in which a declaration of war was in effect. H.J.Res. 1 goes further, adding an "imminent-and-serious-military-threat" provision (hereafter "military threat provision"):

"... The provisions of this Article may be waived for any fiscal year in which the United States faces an imminent and serious military threat to national security and is so declared by a joint resolution, adopted by a majority of the whole number of each House, which becomes law."

The history of the military-threat provision dates to 1982 when one Senator doggedly fought for its inclusion. We believed it was a "Mack truck loophole" and kept it out. Recent military "adventures" confirm that this is a provision that would be dangerous to the integrity of the amendment. Military actions in Somalia, Iraq, Haiti, Bosnia, etc., might well trigger this exception year after year by a Congress seeking ways to avoid the shackles of the limit. We have no history or tradition to draw on to guide us here. It is not worth the risk.

"Declaration of war," on the other hand, has a discernable history. Furthermore, before the Nation makes the kind of resource commitment to military action which might justify setting aside the limit, that decision should be supported by the level of national consensus which an actual declaration of war entails. If a declaration of war is not warranted, Congress may still resort to other exceptions in the amendment if it can muster the super-majority vote for either deficit spending or higher taxes.

DEFINITION OF RECEIPTS. "Tax revenues" also need to be defined, if those words remain in this measure.

DEBT LIMIT. H.J.Res. 9 contained a provision establishing a debt limit in the Constitution. Such a provision was not in early versions of the Amendment. It first appeared in 1986 in response to the demand of one or more Republican Senators who felt that imposition of a super-majority vote to exceed the debt limit would add another level of protection against deficits.

It has always been our feeling that such a provision in a properly designed Tax Limitation/Balanced Budget Amendment (such as H.J.Res. 9) was unnecessary and even surplusage. Furthermore, it has been the Nation's experience that when the debt limit is about to be exceeded, the spending "horse" has already left the barn, necessitating approval of the debt limit increase even by the most fiscally conservative Members.

In H.J.Res. 1, on the other hand, the Judiciary Committee amended the debt-limit section so as to require a vote only to increase "the amount of the debt of the United States held by the public ..." It is not clear what motivated the Judiciary Committee to make this change. However, such a provision will allow the federal government to continue borrowing from the social security and other trust funds without the necessity of a vote to increase this limit. If changing "receipts" to "tax revenues" in Section 2 exempts social security "contribution" increases from the requirement of a super-majority vote, and if those funds can be borrowed without affecting the debt limit (debt held by the public), the size of the federal government can be increased outside the constraints of this Amendment.

If H.J.Res. 1 is revised by restoring Section 2 of H.J.Res. 9, the required vote on increasing the debt limit could create an internal inconsistency and an unintended result. H.J.Res. 9 is designed to accommodate an actual deficit in a down business cycle without a vote (the spending limit in that year could be higher than actual receipts). But unless, by that time, the public debt had been reduced below the public debt limit, a vote to increase the public debt limit would be required, although borrowing would be permissible without a vote.

ROLL-CALL VOTES. H.J.Res. 1 contains a provision for roll-call votes not found in H.J.Res. 9. The requirement for a roll-call vote can be accomplished without a separate section.

ENFORCEMENT AND THE ROLE OF THE PRESIDENT. The last sentence in Section 1 of both versions provides the enforcement "hammer:"

"Congress and the President shall ensure that actual outlays do not exceed the outlays set forth in such statement."

This provision imposes co-equal responsibility and authority on the Congress and the President to make sure the amendment is honored and enforced. Essentially, this creates (or confirms) presidential impoundment authority insofar as its exercise is necessary to stay within the limit. Impoundment is a stronger weapon than a line-item veto for purposes of complying with the amendment because such authority would extend throughout the budget year and would not be subject to congressional override.

It is intended that this dual enforcement authority induce Congress to establish a set of internal spending rules such as rescissions, across-the-board reductions, etc., that will enable it to stay within the limit (certainly Congress would not want any of its budget-shaping authority to flow to the President by default).

The liberals in Congress have fought us every inch of the way on this design, not wanting real enforcement of the amendment. Unfortunately, the language which they have selected to diminish the role of the President, and enhance that of the Congress, in terms of enforcing the amendment has found its way into both versions:

"Congress shall enforce and implement this article by appropriate legislation."

Such a provision is found in several amendments to the US Constitution — those which apply to the states (13th, 14th, etc., amendments). But inserted in this amendment such a provision is dangerous and can lead to an unintended result.

What we giveth the President as enforcement power in Section 1, we taketh away with this provision because Congress, through implementing legislation, can circumscribe the scope of the President's authority under the amendment. This invites mischief and opens the amendment to needless controversy.

EFFECTIVE DATE OF THE AMENDMENT. H.J.Res. 9 calls for an effective date of 1999, whereas H.J.Res. 1 pegs it as 2002. This is a matter of judgment, of course, but we can put the "start date" too far off in the future to be credible. Five years ought to be more than ample time to get the budget in balance; and it provides the incentive to get at that job now.

ADDITION OF A MANDATE PROTECTION SECTION. States and local units of government are demanding protection from the costs of implementing federal mandates. Although Congress is at work on a statute to remedy this problem, constitutional control is essential for long-term protection.

In my judgment, this Amendment is the logical and proper vehicle for a mandate protection provision. Such a measure was included in the Tax Limitation/Balanced Budget Amendment approved by the United States Senate in 1982, so there is precedent for its inclusion here.

Several mandate protection provisions have been fashioned by constitutional and other experts. Bill Niskanen, among others, has developed a thoughtful approach.

The inclusion of a proper mandate protection provision will no doubt assuage state concerns during the ratification process, enhancing prospects that this Amendment will become part of our Constitution. It is my belief that such a provision may well be helpful to the approval of this Amendment by the Congress, as well.

PREPARED STATEMENT OF
GOVERNOR STEPHEN MERRILL

Chairman Mack, members of the Joint Economic Committee. I come here today to speak on behalf of the Balanced Budget Amendment to the United States Constitution. I am the Chair of the New England Governors Association and the Chair of the Coalition of Northeast Governors, but I am here today to testify as the Governor of New Hampshire.

I am pleased to come here today and to speak to you on behalf of the hard-working citizens of the Granite State. I am honored to speak as their Governor and I am honored to be here with all of you.

I do not come here today to dictate statistics and percentages about budgets. Rather, I would like to talk to you today about purpose and resolve, and the need to balance the federal budget on behalf of the people of our nation.

Each of you, and to some extent all elected officials across this nation, are caught in the winds of dramatic change sweeping across America's political landscape. You are charged with beginning the critical process of balancing the federal budget, a task that has eluded Congress since 1969.

For twenty-six continuous years the federal government, Republicans and Democrats alike, have allowed the tyranny of red ink to threaten the economic stability and the democratic principles of our nation.

The result of this failure of resolve is clearly evident. Hard working middle class families have been forced to shoulder excessive economic burdens, higher and higher taxes, and even a decreasing standard of living.

Our citizens face the growing need for two incomes to support a family, while these same families struggle to fulfill the most basic aspect of the American dream, buying and owning a home.

As the Governor of New Hampshire, I have come here today to respectfully inform you what we in New Hampshire believe you must do. And why we believe it is of tremendous importance that you do it now.

I believe our people are way ahead of elected officials on this issue. Our citizens' concern is not receding, as some thought it would after the election of 1992, rather it is growing stronger and more powerful. It is not a coincidence that more than half of the House of Representatives has been elected since 1990. It is no longer politically incorrect to use New Hampshire terms, such as "cutting spending," "dramatically reforming and reducing welfare dependency," and "expecting personal responsibility from each and every individual." This time has come to deal with the greatest threat to the well-being of Americans, the inability of our federal government to balance its budget without raising taxes. And it must balance its budget in a manner that does not send unfunded mandates to be paid for by the citizens of our states.

As a former Attorney General, one who has studied our nation's Constitution and loves it, I recommend amending it only after considerable reflection. I simply know

of no other way to restore belief in our citizens that this government can be responsive to the principles and values that made this country great.

This amendment takes a giant step toward restoring the respect that our government at all levels ought to have, no longer viewed as a giant bureaucracy that has lost its way and become an impediment in the struggle of our nation's citizens to achieve their dreams.

I am a strong supporter of the Contract with America because it reflects the values that already exist in New Hampshire. To a significant degree an attempt to make the elements of the Contract with America the principles of our government is, in my opinion, an attempt to make the federal government more reflective of the governments that already exist in several states. In my case, the Contract with America is more like making America like New Hampshire.

In New Hampshire, if Granite represents our resolve, limited spending defines our commitment.

You should know that in New Hampshire we do not have a balanced budget amendment. You should also know that we do not pass deficit budgets.

- o In New Hampshire it is against the law for a sitting Governor to submit an unbalanced budget.
- o In New Hampshire it is against the law for the Finance Committee, which oversees the budget process in our House of Representatives, to submit to that House a budget not in balance.
- o In New Hampshire, it is illegal for a department head to deficit spend.
- o New Hampshire has a Revenue Stabilization Act ("Rainy Day Fund") which reserves 5% of the State's surplus for future economic downturns. This fund cannot be invaded unless a super-majority of the Legislature votes to do so.

Some will claim that New Hampshire is a small state and therefore better able to maintain its finances. That is simply not the case. All governors share common problems and seek common solutions. In New Hampshire, however, balanced budgets are required.

What makes the New Hampshire argument on a balanced budget amendment believable is that for 200 years we have balanced our budgets despite the fact that we have no broad based tax. Let me say that again. For 200 years we have balanced our budgets in New Hampshire with no income tax and with no sales tax.

In my first year as Governor I initiated the most sweeping change in the New Hampshire tax code in the last 25 years. In doing so, we were able to cut three taxes and eliminate two taxes completely, and yet our revenue has grown rather than diminished with those changes. The reform of the business tax structure included a super-majority provision. I refused to support the legislation without the super-majority provision. The entire New Hampshire Tax Reform Act of 1993 was revenue-neutral and did not raise taxes for New Hampshire citizens.

Last year, after coming through the worst recession since World War Two, we not only balanced our budget, we sent more money back to the cities and towns to lower property taxes than any prior administration in history.

And in New Hampshire each year we send more money back to the federal government in taxes than we get back from the federal government in programs or money. We are one of the few states to attain that unusual distinction.

We in New Hampshire are not balancing our state budget on the back of the federal government, or through the hard-earned tax dollars of our working families. We do it through discipline, determination, commitment and most of all, a sense that we are protecting the future for those who choose to live in New Hampshire.

Is it easy? No.

In our final budget negotiations for the 1994/95 biennial budget, three different budgets were considered: the Governor's budget, the House budget, and the Senate budget. My budget proposal was the lowest submitted. Some believed that I should compromise and simply choose a member between the highest budget and the lowest budget. I refused. I believed that the only way to balance the budget of New Hampshire, without deficit spending, was to accept the balanced budget.

That refusal to compromise may well be remembered as the hallmark of my administration. The taxpayers of New Hampshire won a great victory.

In addition to balancing our State government budget and sending money to the cities and towns to lower property taxes, we also assumed direct cash payments for a sewer, water and landfill projects at the local level. But even more importantly, we convinced the people of New Hampshire that we could balance a budget in difficult times and that in turn led to other successes.

In the face of a recession we cut taxes. We created jobs--slashing the unemployment rate in half. We reformed our welfare system, instituted a health care plan for the uninsured, and significantly cut back government regulations on businesses and individuals.

We unleashed the spirit of freedom and responsibility and entrepreneurship in our people and the result is that our State is stronger today than ever before.

I know you will want to know what has happened to New Hampshire as a result of its years of limited spending, lower taxation, and balanced budgets.

- o In the *Wall Street Journal*, the CATO Institute gave us an 'A' for fiscal responsibility in managing state government.
- o We were named the "Most Liveable State" in the country once again.
- o We have an award-winning mental health system considered the best in the country;
- o Our correctional system is recognized nationally as among the best;
- o This year our students ranked first in math and reading and are again at the top of the 'SAT' scores.

Many governors have visited Congress to explain how they are effecting change in their states. They have outlined successful programs on various issues and because of their actions their states are stronger today. I urge you to listen to their ideas and to balance your budget as they do.

That is why I can call upon you to pass the Balanced Budget Amendment to the Constitution.

The Balanced Budget Amendment is a bold step, but the nation's governors will assure you that the American people are ready for bold change. They are tired of the status quo. They have grown frustrated with excuses as to why the federal budget can not be balanced. They are waiting for you to act.

Doing what is right is never a long-term liability in politics. Our citizens respect the fact that we as elected officials must make difficult choices. Balancing our federal budget, relieving the tax burden on the middle-class, stopping unfunded federal mandates, and changing the attitude that our children will somehow be able to pay for our financial mismanagement will not be easy, but it will be right.

Our nation's governors are doing their jobs despite the inability of Washington to balance its budget for so many years and despite the torrent of unfunded mandates that we are forced to deal with every day.

I urge you to keep the Contract with America and to do so in a bi-partisan spirit that reflects positive change for all our citizens. In the face of the special interests, the lobbyists and all those who refuse to change the status quo, it is time to do what is right. The Balanced Budget Amendment is an enormous step toward restoring fiscal responsibility to the American political process and restoring fiscal respectability to the Congress.

You serve at a moment in history that can return the Congress of the United States to a policy of fiscal sanity. Do not fear what lies ahead. Your resolve should be strengthened by the failure of a generation of political leaders which lie behind you.

You must move forward. I promise you the American people will be with you.



COMMONWEALTH of VIRGINIA

Office of the Governor

George Allen
Governor

TESTIMONY BY THE HONORABLE GEORGE ALLEN GOVERNOR OF VIRGINIA

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

562 DIRKSEN SENATE OFFICE BUILDING
WASHINGTON, D.C.

JANUARY 20, 1995

Mr. Chairman, members of the Committee, good morning. Thank you for inviting me to address this hearing of the Joint Economic Committee.

It's a pleasure to discuss the proposed Constitutional amendment requiring a balanced federal budget. This is an issue which I strongly believe would help restore *accountability* and force a much-needed *discipline* on the federal government. Indeed, my good friend, Senator Jon Kyl of Arizona, and I worked hard to pass such legislation when we were members of the U.S. House of Representatives.

I also would like to relate to you some of our experiences on Virginia budget issues and tax cuts. Our Administration is working hard to change the "big government knows best" mentality that has been so prevalent, not only in Washington, but also in our statehouse in Richmond -- until I took office.

As I just mentioned, I had the pleasure of serving with many of you several years ago as a member of Congress. During my term, I sponsored legislation that was the primary Republican substitute when the House voted on the Balanced Budget Amendment in 1992.

The amendment which then Congressman Kyl and I introduced would have limited federal spending to 19 percent of the gross national product. Because we believed that Americans should not be saddled with a heavier tax burden, our amendment protected the American taxpayer by requiring approval by a three-fifths majority of Congress to exceed spending limits or increase taxes. Our amendment also included line-item veto authority for the President.

We introduced this legislation because the federal government has had a voracious appetite for the hard-earned money of the taxpayers, and because it continues to spend far more than the enormous amount of revenue it collects.

In the end, however, the guardians of the "big government" status quo prevailed. They succeeded in stopping, not just ours, but *any* balanced budget amendment from passing that year. I regret that opponents chose scurrilous scare tactics over spending discipline, taxpayer accountability and fiscal responsibility.

Let's not allow that to happen this time.

SPENDING CUTS KEY TO DEFICIT REDUCTION

In recent years, there have been numerous scandals in the federal government. But none is so blatantly fraudulent and unfair to the American taxpayers as *uncontrolled deficit spending*.

I believe that Congress should be forced to accept the same responsibility that is imposed on a majority of the States. You can do that by passing a constitutionally required balanced budget and giving line-item veto authority to the President. By taking these actions, the federal government will no longer continue to drown future generations of Americans in a sea of red ink and growing debt in which interest payments swell to take an ever-increasing and excessive portion of current revenues.

The balanced budget amendment requires Congress' immediate action. I urge you and your colleagues to fulfill your commitment to the American people. Make the tough decisions needed to reduce wasteful or inappropriate spending. Cut the federal deficit. And start paying off the national debt.

I know that, as a member of Congress, I was chastised by some for voting against appropriations bills that increased federal spending. But I kept faith with the people who elected me. The people want and expect discipline and accountability in their Congress and throughout their government.

For some, however, this may be a bitter pill to swallow. But it is the only medicine that can begin to cure the fiscal ills of our federal government.

The constitutional amendment requiring a balanced federal budget is *not* a unique or unproven concept. It has been implemented by virtually every State. It is part of most of their Constitutions and their laws. *And it works.*

VIRGINIA'S CONSTITUTION REQUIRES A BALANCED BUDGET

The Executive Branch in our Commonwealth operates within the discipline and accountability established by a constitutional balanced budget requirement.

Under Virginia's Constitution, any budget I, as Governor, propose to the State legislature must be in balance. Spending cannot exceed revenues.

Unlike the U.S. Congress, we have a two-year budget cycle in Virginia. In addition to making sure that the budget is balanced at the beginning of the biennium, I am required to make sure that the budget *stays* in balance throughout the biennium.

Balancing budgets requires *resolve* and *discipline*. As the Governor of a Commonwealth with a balanced budget requirement, when I recently proposed cutting taxes by \$2.1 billion to rightly let Virginians keep more of the money they earn and produce, I had to recommend commensurate cuts in spending to offset the reduction in revenues. And that's exactly what we did.

But let me warn you: The road before you is not easily traveled.

The battles you will face with the guardians of big government will be tough. Opponents will argue that cuts can be made – but never in the programs in which *they* have a vested interest. Since we submitted our record tax cut proposal in Virginia and the accompanying spending reductions to pay for that relief and other priorities, we have been under constant attack from the naysayers who claim that it can't be done. They believe that government must continue to grow.

We're having a *lively debate* in Richmond about our proposed tax cuts and spending reductions, about the proper role of government and about the rights and responsibilities of citizens. But when we're finished, we, in Virginia, will have done something that I haven't seen accomplished for a long time in Washington – we'll have *set priorities*.

By passing the balanced budget amendment, Congress can create a strong incentive to prioritize federal government spending and manage government services more efficiently and effectively. The American taxpayer would welcome such a change.

END TO UNFUNDED FEDERAL MANDATES KEY TO STATE FLEXIBILITY

I know you are hearing all kinds of comments, caterwauling and dire predictions here in Washington from those in opposition to a balanced budget amendment to the Constitution.

There have even been concerns recently from some of my fellow Governors that we shouldn't have a balanced federal budget because it would mean less money flowing from Washington to the states.

I understand this concern. To my colleagues in Governor's offices across the nation, and to each of you, I simply say that a balanced federal budget can – *and must* – be accomplished without raising taxes on the American people, and without forcing unfunded mandates down the throats of state and local governments.

We are fully prepared to make the necessary adjustments in our Virginia state budget that a federal balanced budget amendment would require – so long as states do not have to function under the heavy hand of unfunded federal mandates.

As the majority of Governors who gathered in Virginia last November declared in our *Williamsburg Resolve*, we are prepared to take on the responsibilities for welfare reform and other priorities, such as education and law enforcement, that can best be carried out at the state and local level. But Congress *must not* tie our hands with excessive regulations and burdensome costs passed on to the states.

This year, the United States will pay \$235 billion in interest on the national debt. Every year, more and more of the federal taxes taken from hard-working Americans are used just to pay interest on the \$4.8 trillion debt the federal government has run up. If we don't take positive action soon, interest payments will continue to crowd out other spending, and the federal government will choke state budgets with enormous unfunded mandates.

The time to act is now!

The longer you wait to enact such discipline, the worse it will get.

No doubt some will argue against a balanced budget amendment on the grounds that the Constitution should not be changed. Obviously, however, the framers thought that the Constitution should and could be amended in the future to address changing conditions and pressing needs.

For far too long, Congress has failed to properly manage the finances of the federal government. No state government, private company, or American family is permitted to irresponsibly and continually spend money it does not have. Why, then, should Congress be exempt from doing what millions of Americans do every month? -- balance their checkbooks.

Thomas Jefferson *opposed* granting the federal government the power to borrow money. In fact, in 1798, he advocated a constitutional amendment to take away this power. While Jefferson's amendment may have been unnecessary during the early years of our Republic, circumstances certainly have changed.

The federal government has run deficits in 33 of the last 34 years. It has run a deficit every single year for the past 25 years -- *an entire generation*. This is outrageous and inexcusable.

Fiscal irresponsibility and a lack of government accountability have necessitated a balanced budget amendment. As Mr. Jefferson wisely cautioned, "In questions of power, let no more be heard of confidence in man, but bind him down from mischief by the chains of the Constitution."

I urge each of you to support a balanced budget amendment to our U.S. Constitution.

The Kyl-Allen Balanced Budget Amendment that I sponsored included protection for the American taxpayers against tax increases to reduce the deficit. I continue to believe that the ideal balanced budget amendment would require a "super-majority" to raise taxes.

The federal government does not have a deficit because its *taxes are too little*.

It has a deficit because it *spends too much!*

To me, a balanced budget amendment with a tax limitation is *sound economic policy*. And it's *sound public policy*.

In fact, I am submitting legislation in this session of our Virginia General Assembly to require a two-thirds "super-majority" in both houses of our state legislature before any tax increases can be enacted.

THE VIRGINIA PLAN

Virginians, indeed all Americans, are looking to their state and federal governments to cut down on government interference in their lives and government grabbing at their paychecks.

Since our administration announced on December 1, 1994 that we would seek a \$2.1 billion tax cut for all taxpaying Virginia families and small businesses, the ever-present and always vocal naysayers have presented a litany of excuses as to why they believe we should not cut the State income tax and eliminate the despised gross receipts tax.

The tax relief I have proposed will be particularly beneficial to hard-pressed working families with children and businesses, especially small businesses that are the engines of growth and job creation.

Our proposal will *triple* the personal, dependent, age and blind exemptions for the State income tax from the present level of \$800 to \$2400. And our tax cut would be retroactive to January 1, 1995 and phased in over a five-year period.

Each and every Virginia State taxpayer will realize some much needed tax relief. Under our tax cut plan, up to 84,000 low-income, working Virginians will *no longer* be required to pay *any* state income taxes *at all!*

I urge you to force the same discipline on the federal government that we are fighting to impose on Virginia's state government.

By cutting taxes in our state, and with Virginia's balanced budget requirement, we will force spending by state government to be reduced in the future. This fiscal discipline is essential. Why? Because as we have seen in Congress, every available dollar gets spent. A balanced budget amendment coupled with tax cuts will give the people what they are demanding, not just in Virginia, but across the country -- a leaner, more efficient government that's focused on essential responsibilities.

I believe that supporters of a balanced budget amendment must have firm resolve. We must offer thoughtful, positive solutions to the federal deficit sham and an abhorrent federal debt that's rapidly approaching *\$5 trillion*. Americans expect their leaders to stand up to the farcical scare tactics of the guardians of big government who want to avoid discipline, scrutiny, and accountability.

ESTABLISHMENT AND SPECIAL INTERESTS MISLEAD CITIZENS

Clearly, the Clinton Administration and its allies have attempted to instill fear of a balanced budget amendment. Their approach is one which assumes that government should continue to operate under the tax and spend philosophy that has so tarnished the image of the federal government in the public's eye.

Just as we are doing in Virginia, the federal government must look beyond the failed experiments and misleading philosophies of the past. The idea that government spending must grow by leaps and bounds year after year, with little or no accountability to the taxpayer, is a time bomb waiting to explode. And it *will explode* – if government does not heed the warning that the American people have issued.

The guardians of big government do not want you to succeed in passing a balanced budget amendment. Their efforts proceed from the assumption that the taxpayers money first belongs to government; that the government should collect through taxes as much as the people will permit; and that it's the government's job to redistribute the taxpayers' money in ways politicians and bureaucrats think best.

I believe that taxpayers' money belongs to the people who earned and produced it. The American people know better than any government official how best to use it.

DO WHAT IS RIGHT FOR TAXPAYERS

Mr. Chairman, I hope that this committee and indeed, the entire Congress, chooses the principled path which we in Virginia took years ago – adopt a balanced budget requirement.

Adopt this common sense initiative and send it to the States and to the people for our ratification as quickly as possible.

Seize this tremendous opportunity to pass this truly historic and principled legislation.

If we are diligent and determined in our attempts to bring discipline and accountability back to government, we can begin to fulfill our duties as responsible public servants.

For a change, let's do *not* what is convenient for government. Let's *do* what is *right* for the American taxpayers.

Pass the Balanced Budget Amendment with taxpayer protection – now!

Thank you.

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PREPARED STATEMENT OF LAWRENCE CHIMERINE

My name is Lawrence Chimerine. I am Managing Director and Chief Economist of the Economic Strategy Institute. I appreciate the opportunity to testify before the Joint Economic Committee on the advisability of a constitutional amendment to balance the federal budget.

In sum, my views are as follows:

A. While the Clinton administration economic and budget program enacted in 1993 has dramatically improved the deficit outlook, future deficits will still be unacceptably high without further policy actions. In particular, while the deficit is now falling, most projections suggest that it will start rising again in approximately two years, and will continue to rise substantially into the next decade.

B. Deficits do matter. In particular, cutting the deficit is the only reliable way to increase our anemic national saving rate in order to provide for higher investment in the long term -- this is necessary to increase productivity, improve our international competitiveness, and to create a rising standard of living for most of our citizens. Cutting the deficit will also bring down real interest rates and reduce our dependence on foreign capital, both of which are also desirable in the long term.

C. There is no simple rule to guide future budget deficits. My own view is that a multi-year deficit reduction program should be enacted as soon as possible to reduce the projected deficit in ten years by at least one-half, but to allow for delays of part or all of the policy actions if economic growth in any year is below a specified minimum level. This will avoid excessive fiscal drag at a time when the economy may already be weak, but at the same time will generate confidence in financial markets that significant future deficit reduction will occur in order to get the maximum impact on long term interest rates as soon as possible.

D. Despite my view that it is important that we bring down future budget deficits, I am strongly against enactment of a balanced budget amendment, for several reasons. First, striving for a balanced budget in the year 2002 may create too much fiscal drag, especially during the next several years when the effect of recent increases in interest rates and other factors begin to slow economic growth. Thus, it may not be good fiscal policy -- at a minimum, it may be necessary to stretch out the period for reaching a balanced budget considerably. Secondly, it will be extraordinarily difficult to achieve a balanced budget in the year 2002 without decimating some major programs which are important for our economic and/or social well being, or without significant tax increases. This would be especially the case if defense, social security benefits, and some other entitlements, as well as the now largest interest component of federal spending, are excluded from cuts -- this would require extraordinarily large cuts in other programs. Since many of these programs affect the poor, many people will be badly hurt, or it will force state and local governments to sharply raise taxes in order to reduce their pain. Spending cuts are also likely to effect programs that are needed to help build for the future, including public infrastructure, support for research and development, education, etc. -- this too would be unwise. Third, the requirement to balance the budget in every year would make the business cycle worse by requiring spending cuts or tax

increases during recessions, exactly the opposite of sound macroeconomic policy. Fourth, it will likely result in budget gimmickry, such as the use of optimistic assumptions, putting programs off budget, etc. to reduce the difficulty in actually facing up to the spending cuts or tax increases that would be required. In the long run this could actually make future deficits even worse.

E. I am particularly concerned about consideration of a balanced budget amendment at the same time that there appears to be a head-long rush to enact sizable tax cuts and to increase the defense budget, and to make it more difficult to even come close to balancing the budget in the years ahead, or even in fact to put the deficit on a downward trend. Furthermore, while no one likes tax increases, it is not desirable to reduce our future flexibility on the tax side because we may reach a point where tax increases are necessary in order to reduce budget deficits, or to fund vital programs.

The Evolution of the Deficit Problem

Many still believe that the enormous deficits of the last fourteen years have been the result of overspending by Congress. However, today's massive deficits, as well as those during the 1980s, were directly attributable to the misguided economic policies that were implemented in the early 1980s under the banner of supply-side economics. Multi-hundred billion dollar deficits for as far as the eye can see were predictable at that time because:

1. The mythical spending cuts that would supposedly result from the elimination of waste, fraud, and abuse were enormously exaggerated from day one.
2. The incentive effects of supply-side tax cuts were inconsistent with most empirical evidence, and thus were enormously overstated.
3. Thus, not only did the big military spending increases and large tax cuts put massive pressure on the deficit, but the anticipated spending offsets, and the added revenues from economic growth, could never and did never materialize.
4. Furthermore, the explosion in health care costs and other entitlements have pushed the cost of those programs far beyond earlier expectations.
5. The problem was worsened by the use of extremely optimistic (and usually inconsistent) economic assumptions, understatement of program costs, budgetary gimmicks, etc which enabled the Reagan administration to consistently present budgets that were projected to be in balance, when in truth there was virtually no possibility of that occurring.
6. Finally, the problem began to feed on itself. The accurate projections created an attitude of indifference and neglect which prevented any real solution to the deficit problem, thereby causing the national debt to skyrocket so that interest on the debt began to grow at an enormous rate.

Budgetary Myths

The move toward a constitutional amendment to balance the budget clearly reflects the frustration which currently exists in the Congress regarding the inability to effectively deal with the deficit problem, as well as an effort to find a way to avoid making the hard decisions. It also appears to be an indirect admission of guilt by the

Congress that they in fact are also responsible for the budgetary mess. The real problem, as mentioned earlier, was the lack of leadership by the Reagan Administration during those years, and the spreading of a number of budgetary myths that perpetuated the inaction. As indicated earlier, these included the following:

1. Waste, fraud and abuse -- the idea that multi-billions could be saved by eliminating waste, fraud and abuse in government programs -- a painless solution that was abused from day one.

2. Tax cuts would pay for themselves (even more than pay for themselves) because of strong incentive effects which would create faster economic growth -- there was no legitimate economic evidence to support the conclusion that the large tax cuts enacted in the early 1980s would have the huge impact on savings, investment, and work effort that had been predicted, nor would it produce the strong economic growth which underlied economic and budgetary projections at that time. As a result, it was clear that the tax cuts would result in substantial revenue side because tax revenues actually increased as a result of the tax cuts of the early 1980s is inaccurate. Both personal and corporate income tax collections as a share of income and profits respectively are far below where they were a decade ago -- total tax revenues are roughly at the same ratio of GNP as they were prior to the enactment of the supply-side program primarily because of the big increase in Social Security taxes enacted in the mid-1980s, and because of other tax increases enacted along the way.

3. We will grow our way out of it -- this was another form of the argument stated above, which, as mentioned earlier, was insupportable for day one.

4. State and local budget surpluses will offset the Federal deficit -- this too way a red herring which was employed by those who were belittling the deficit in the 1980s. State and local surpluses were never large enough to come anywhere near offsetting Federal deficits.

5. Deficits don't matter -- when all the arguments mentioned above turned out to be wrong, it was asserted by the Reagan administration that deficits don't really matter anyway. They cited the economic expansion of the 1980s, despite the deficit, as proof. Of course, as many of us pointed out at the time, we were able to attract massive sums from overseas to help finance those deficits and extend the economic expansion -- any reasonable expectation was that the flow of capital from overseas would eventually fade out, as has now been the case.

6. The deficit is due to Congressional overspending -- once previous Administrations ran out of rationalizations, the blame shifting began. The truth is, however, that Congress has appropriated less money for discretionary programs (usually in defense) than the Administration asked for in ten out of the twelve years between 1980 and 1992. In fact, discretionary non-defense spending and grants-in-aid to state and local governments were cut substantially during the 1980s, not only relative to earlier current service projections, but as a share of the total budget, and as a share of total GNP. Many domestic programs have fallen sharply in real terms as a result.

We all know why the deficit is still huge and why the problem has not been addressed. It's because of dishonesty in the budgeting process, and lack of leadership from previous Administrations, which resulted in a series of proposed budgets which purportedly balanced the budget in "out years" based completely on mythical savings, extraordinarily optimistic assumptions, budgetary gimmicks, program understatements, etc. The problem was essentially assumed away. Perhaps Congress should have taken the lead on its own, but it was unrealistic to expect 535 Senators and Congressmen, each with their own constituents, to take the lead on a matter like this.

The Current Deficit Outlook

The Clinton Administration and Congress enacted the most significant deficit reduction package in 1993 since the problem developed. The combination of spending cuts and tax increases enacted will reduce the level of the deficit each year beyond that time. Furthermore, unlike previous attempts to reduce the deficit, this is real deficit reduction -- it was based on realistic economic assumptions and estimated impacts of the specific policy actions, so that the actual reduction in the future will closely match the estimates provided at the time the budget was implemented.

Unfortunately, however, the deficit outlook is still poor. While the deficit in the next two fiscal years will be about half of the near \$350 billion annual level experienced in the early 1990s, in great part because of the new deficit packages, as well as because of the economic recovery, virtually all projections indicate that the deficit will begin to rise again by fiscal 1997, and will continue to rise at a substantial rate into the next century. For example, the Congressional Budget Office is now projecting that the deficit will rise to over \$400 billion in the year 2004, from the approximately \$180 billion projected for fiscal years 1995 and 1996. These projections imply increases in the deficit to GDP ratio, and in the national debt to GDP ratio. In great part, this reflects the bottoming out of defense spending near the end of this decade, as well as continued increases in the cost of the entitlements. Furthermore, this horrendous deficit outlook is in reality even worse because it includes sizable surpluses from the Social Security trust fund -- when these trust fund surpluses begin to be paid out in benefits early in the next century, the unified deficit is likely to skyrocket unless steps are taken to reverse current trends.

Cutting the Deficit Is Important

This outcome is unacceptable. It should now be clear that these enormous deficits do matter. They have already begun to slowly suck the vitality out of the U.S. economy by squeezing out productive investment, keeping real interest rates extraordinarily high, increasing our dependence on foreign capital, reducing the effectiveness of fiscal policy as a stabilization tool, and by creating pressures on those Federal programs that are needed to help build our economy for the future. In my view, the urgency to reduce the deficit is even greater now than it was in previous years, for the following reasons:

1. Personal savings have declined since the 1980s, despite the supply-side incentives, thus reducing the supply of domestic savings.

2. The flow of capital from Japan, Germany, and other parts of the world, which helped fund our deficits in the 1980s when we were the world's major capital importer, has slowed dramatically. This is resulting from the fact that many of those countries are no longer generating surpluses at the same degree as they were previously, and because other parts of the world have become large capital importers as well.

3. A consensus is finally developing that the most critical need in the United States is to improve our productivity and competitiveness -- we can no longer grow, as we did in the 1980s, by building empty office buildings and patriot missiles, and by leveraging the system, while long-term growth factors are deteriorating. It is clear that competitiveness will require substantial increases in investment, including modernizing our capital stock, investing in education and job training, and rebuilding our infrastructure. High real long-term interest rates, largely caused by massive deficits at a time of lower domestic savings and a reduced inflow of foreign capital, will discourage some of our needed investment.

In effect, it is essential that we create invest-led growth in the United States in order to begin to build for the future. But to do that, the federal deficit must be gradually reduced in order to free up more of our savings, to finance private investment, and to reduce real long-term interest rates. Furthermore, it is essential that government priorities be changed at the same time that deficits are reduced -- clearly, more federal spending is needed for rebuilding the existing infrastructure and developing infrastructure of the future, improving the quality of education, funding more non-defense research and development, and for other such programs that will both directly improve U.S. productivity, and help begin to rebuild the U.S. economy. The challenge of course is how to do both -- across the board spending cuts, or any other method that does not result in the necessary change in priorities, will not be sufficient if our objective is to get the U.S. economy on the right course for the future.

A balanced budget amendment is NOT the Answer

Despite the urgency of reducing future budget deficits, I am strongly opposed to the enactment of a balanced budget amendment. In my judgement, it is simply another gimmick like those that have been implemented in the last six or seven years, beginning with Gramm-Rudman, which have had very little, if any, impact. It will not only be an ineffective tool in dealing with the problem, but in my view is simply a way to attempt to avoid what will be difficult choices, and place the blame for any unpopular spending cuts or tax increases on a mechanical formula rather than on Presidential or Congressional decisions. In brief, my concerns, are as follows:

1. Which budget is to be balanced? Is it the structural budget deficit, the unified budget deficit, the on-budget deficit, etc.? Should government investment be included or excluded? Answers to these and similar questions are not intuitively obvious.

2. It is likely to encourage even more use of optimistic forecasts, program underestimation, moving programs off-budget, and other similar techniques in order to avoid the tough decisions that will be needed to be made to actually balance the

budget. Thus, the Balanced Budget Amendment has the potential of making the budget process even more flawed than it was in the 1980s. We are also likely to see the adoption of more gimmicks that produce short-term revenue gains at the expense of revenue loss beyond the balanced budget period which will simply make the long-term problem even worse.

3. There are times when a balanced budget may be undesirable. These may include periods of recession or slow growth, wartime periods, or situations when domestic emergencies might exist. In my view, it will be difficult to plan for all these contingencies in a balanced budget amendment, and any effort to offset these factors will be harmful to the economy. Furthermore, its goal of reaching a balanced budget in a relatively short period of time may create too much fiscal drag too rapidly.

4. In my view, it will probably make it more difficult for us to deal with our other critical budget problem, namely reorienting our priorities, because the tendency will be to look for the easiest ways of cutting the deficit, rather than those that are best for the economy.

5. What if, in fact, a balanced budget isn't achieved because the economic assumptions turned out to be incorrect, even if they were reasonable in the first place? How do we make adjustments for it? Who gets penalized? There are also difficult issues that would have to be covered.

6. Efforts to enact major tax cuts at the same time that the Balanced Budget Amendment is being debated is the height of cynicism, especially the tax cuts that have been proposed in the Republican Contract with America. Those tax cuts would generate sizeable revenue losses, especially in the out years, making what will already be an extraordinarily difficult task of substantial deficit reduction (let alone a balanced budget) in seven years virtually impossible without almost a near dismantling of government programs except for social security and national defense. This is the height of cynicism, as well as horrendously bad social and economic policy.

It is also important to remember that the Federal budget, by its sheer size, and because of its role as a stabilization tool, should not be considered in the same way as an individual state or local government.

How to Cut the deficit

While additional long term deficit reduction is thus essential, this must be balanced with two other objectives. First, it is important that we do not further undermine the use of fiscal policy as a stabilization tool. In particular, it would be counterproductive to cut the deficit so quickly that we would dramatically weaken the economy when it is already operating below full employment. Second, we need to reduce future deficits in a manner that would not make it more difficult for us to deal with our other critical budget problem, mainly reorienting our priorities away from consumption and more toward public investment and other expenditures that are needed to support long term economic growth.

I suggest the following approaches an alternative to a balanced budget amendment.

1. Unfortunately, there is no precise rule of thumb or model simulation which can give us the optimum path for future deficit reduction. In my view, an appropriate

objective would be to cut the \$400 billion dollar deficit now projected by CBO for 2004 in half -- this would suggest that over the next 10 years the nominal deficit would be roughly flat, implying a gradual decline in the deficit in real terms, in the deficit as a share of GDP, and even more importantly, in the debt to GDP ratio. Such a target would imply putting in place approximately \$15-20 billion dollars per year of budget restraint for each year over the ten year period in my judgement, with the safeguards I will list below, I think this is doable and will not create too much fiscal drag on the economy.

2. Spending cuts should be the top priority. In view of the large cuts in non-defense discretionary programs in the 1980s, and given the need to increase spending in some of these areas, it is unlikely that huge savings will be realized from this sector of the budget. Thus, spending, from an effective health care cost control program, and from slowing the enormous growth in the entitlements, especially the pension and health programs. I would suggest that the concept of entitlement is no longer something that this country can afford. All of the so-called entitlement programs must be slowly converted to means testing, either by scaling back benefits for upper income and high wealth individuals and/or increasing taxes on those benefits. We should reduce (not eliminate) benefits for those who could do with less -- households and individuals with modest means should be spared. Furthermore, consideration should be given to further extending the retirement age for full benefits. Scaling back of health and pension benefits should not apply only to entitlement programs -- public employees are now receiving extremely generous benefits which are no longer affordable. Finally, I would suggest that any reductions in social security benefits partly be earmarked for investments to build for our future, especially for education and other programs which benefit primarily younger people. In effect, we would be reducing benefits for the elderly to be used to make a better life for their children and grandchildren.

3. Deficit reduction must be fair. In particular, it is now well documented that most of the benefit of the tax cuts of the 1980s went to those in the upper income groups -- in the meantime, large social security tax increases and budget cuts have significantly reduced after-tax incomes for many low and middle income families. This has only been partly reversed in the 1993 budget package. Thus, it is important that deficit reduction be structured in a way that the impact is greatest on those who can afford it. Many will make the argument that increases in taxes on upper income individuals will create huge disincentives for savings and investment and thus would be counterproductive -- however, as we learned in the 1980s, these arguments are exaggerated. Furthermore, the economy can not function effectively when a large and increasing share of purchasing power and wealth is concentrated in relatively few hands -- this holds down demand and thus will prevent long term growth.

4. The arithmetic is very clear -- even with the phasing-in of entitlement reform and some additional cuts in defense and non-defense discretionary programs, some tax increases (not tax cuts) will be needed in order to reduce deficits to acceptable levels. The assertion that the problem is not on the revenue side because tax revenues have actually increased as a result of the tax cuts of the early 1980s is inaccurate. Both personal and corporate income tax collections as a share of income

and profits, respectively, are below where they were a decade ago -- total tax revenues are roughly at the same ratio of GDP as they were prior to the enactment of the supply-side program primarily because of the big increases in Social Security taxes enacted in the mid-1980s, and because of other tax increases enacted along the way.

In my view, increased revenues should come first from eliminating counterproductive tax expenditures (incentives, exemptions, etc.) Now in place, and then secondly, if more revenues are needed, from increasing taxes in a progressive manner on activities that we want to consume less of. Thus, broadening the tax base and consumption taxes should be considered before across the board tax increases. In the former category, some candidates are the following:

- eliminating or scaling back the interest deduction on merges and acquisitions
- scaling back the deduction for corporate advertising expenses and/or for corporate entertainment
- a lower limit on the mortgage interest deduction than is now in place
- taxation of a portion of corporate health care insurance premium (this may also be helpful in controlling health care costs)

5. Most importantly, I believe that to the extent possible, a multi-year program designed to bring about the amount of deficit reduction described above should be adopted as soon as possible. This would be desirable for several reasons. First, it would avoid having to go through the torturous process on an annual basis -- the medicine can all be taken at once. Second, and more importantly, one way to reduce the effect of fiscal drag on economic growth is to bring interest rates down as quickly as possible, especially long term rates -- this can be best accomplished if the markets believe that a credible program to reduce future deficits is in place. While easier Federal Reserve policy can also help, the Federal Reserve has lost most of its control over long-term interest rates. Convincing the markets that the federal demand for credit will be dramatically reduced in the future will be a more effective way to bring down long term interest rates than an easier monetary policy.

6. It is possible to design a multi-year deficit reduction program that can allow some flexibility to deal with emergencies and recessions. This will prevent fiscal policy from worsening economic downturns. If these exceptions are truly limited, they are not likely to undermine the credibility of the long term program. I suggest that the deficit reduction program be accompanied with an "escape clause" in the form of a minimum level of GDP or employment growth, or a threshold unemployment rate, beneath which future installments of deficit reduction will be delayed or scaled back in order not to create an even weaker economic environment. This is particularly important since the current level of economic activity is so low that the economy is likely to be underutilized for many years.

