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APPENDIX 3

SHOULD THE CONSTITUTION BE AMENDED TO ADDRESS THE FEDERAL DEFICIT?

BY DAVID M. PRIMO



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David M. Primo
Associate Professor of Political Science, University of Rochester
Senior Scholar, Mercatus Center at George Mason University

House Committee on the Judiciary
Subcommittee on the Constitution

Good Morning Chairman Franks, Ranking Member Nadler, and members of the subcommittee. Thank you for inviting me here this morning to discuss whether the U.S. Constitution should be amended to address the nation's fiscal problems.

I am an associate professor of political science at the University of Rochester and a senior scholar at the Mercatus Center at George Mason University.¹ My research focuses on legislative politics and fiscal policy. I have written papers and a book on the subject of budget rules, and I have been following the debate over our nation's future fiscal course with great interest.² In my testimony, I will show why attempts to create long-term fiscal reform, stabilize the debt, and reduce the deficit are likely to fail in the absence of Constitutional budget rules.

The United States faces severe fiscal challenges that can no longer be ignored. Our current \$14 trillion national debt is just the tip of the iceberg. Entitlement spending threatens to bankrupt the nation. The unfunded liabilities from Social Security and Medicare are three to seven times the size of our current debt, depending on how one calculates these figures.³

¹ The views expressed here are my own and do not represent the official positions of the University of Rochester or the Mercatus Center at George Mason University.

² See, for example, Primo, David M. 2007. *Rules and Restraint: Government Spending and the Design of Institutions*. American Politics and Political Economy Series. Chicago, IL: University of Chicago Press. Some passages and ideas in this testimony appear in Primo, David M. 2010. "Making Budget Rules Work." Working Paper No. 10-62, Mercatus Center at George Mason University, available at http://mercatus.org/sites/default/files/publication/Making%20Budget%20Rules%20Work.Primo_.9.28.10.pdf.

³ Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds. 2009. *Annual Report*. Washington, DC: Government Printing Office; Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds. 2009. *Annual Report*. Washington, DC: Government Printing Office. The Medicare Trustees set unfunded obligations for Part B and D at 0 because they are guaranteed funding from general revenues. However, the portion of Part B and D that comes out of general revenues can reasonably be construed as an unfunded liability, since specific revenues are not allocated for this spending (as opposed to Social Security, for which there is a dedicated fund); if these costs are accounted for, unfunded liabilities exceed \$100 trillion dollars.

Any solution to this crisis must accomplish three things: First, Social Security and Medicare expenses have to be stabilized and future promises have to be limited. Second, discretionary spending has to be pared down. Third, future politicians must be prevented from undoing any reforms that are implemented. The focus of my testimony today will be the third of these requirements.

The recent bipartisan attention to the challenges we face is heartening. The dangers of our debt and deficit levels are no longer the province of commissions whose reports gather dust. Instead, we have elected officials taking a stand and proposing bold changes to the status quo. The President's National Commission on Fiscal Responsibility and Reform proposed a serious plan, and legislators from both parties endorsed it. House Budget Committee Chairman Paul Ryan proposed an ambitious plan to control federal spending, and President Barack Obama responded to Chairman Ryan's plan with one of his own. Voters are also paying attention. In a poll conducted by Pew Research Center and *The Washington Post* in April 2011, an astonishing 95% of respondents agreed that the federal budget deficit was a problem, and 81% agreed that action was needed now.⁴

This, in short, is a rare opportunity for meaningful long-term change. I believe that a Constitutional amendment can help us avoid making this a wasted opportunity. In my testimony, I will first establish that opportunities for long-term fiscal reforms rarely emerge. I will then show why long-term reforms are unlikely to be robust without Constitutional change. The next part of my testimony will focus on why it is important to get the rules right and offer some principles that I hope members will follow as they work toward achieving fiscal discipline. I will close my testimony by rebutting arguments against a Constitutional amendment.

THE CHALLENGES OF FISCAL REFORM

The enactment of real fiscal reform is always an uphill battle. Three factors stack the deck against reform:

- Fiscal problems are “creeping” risks.
- The electoral benefits of additional spending typically exceed the electoral benefits of fiscal discipline.
- Pledges made by legislators today will be hard to keep tomorrow.

Creeping Risks

Creeping risks, also referred to as slow failures, develop gradually over time, with any single event having a small but real effect on risk severity.⁵ As enough events occur, the risk ultimately manifests itself in catastrophic ways. The World Economic Forum identifies fiscal crises as one of the major creeping risks facing the world today, and the recent debt crisis in Greece is an excellent example of a creeping risk manifesting itself suddenly.⁶ The U.S. fiscal situation, though perhaps not as dire as Greece's right now, is headed in the same direction.

The temptation when dealing with creeping risks, as opposed to immediate risks, is to postpone action. A bullet to the chest is an immediate risk for which delayed action is not an option. A poor diet, which could eventually lead to heart disease, is a creeping risk. It's easy to avoid action on a diet. It's not so easy to avoid dealing with a bullet wound. The same is true of the federal budget. Many of the most severe risks we face, including the trajectory of Medicare spending, will not manifest themselves in dramatic fashion for years,

⁴ See <http://people-press.org/files/legacy-questionnaires/4-26-11%20Topline%20for%20release%20with%20joint%20WaPo%20deficit%20questions.pdf>.

⁵ Global Risk Network of the World Economic Forum. 2010. *Global Risks 2010: A Global Risk Network Report*. Geneva, Switzerland: World Economic Forum.

⁶ *Ibid.*

prompting many legislators and pundits to argue that tough decisions should be postponed, as well. Unfortunately, the longer we wait to address creeping risks, the bigger the costs will be.

Fortunately, recent statements from legislators in both parties, as well as the president, acknowledge that we ought to take on long-term fiscal problems. To be sure, there are passionate disagreements about how to address these problems. But even agreement that a problem exists is progress.

Electoral Benefits of Spending

The nature of government spending makes it important to take advantage of the current realization that budget reform is needed. The benefits of government programs are typically much more concentrated than the costs of those programs.⁷ If spending and taxes are reduced by \$1 billion through cuts to construction projects, each citizen receives about \$3 in benefits through lower taxes, but the beneficiaries of the construction projects lose far more per capita. It is much easier for a member of Congress to claim credit for preserving the construction project than to claim credit for the savings from eliminating such a project. The politics of fiscal reform, then, are stacked in favor of beneficiaries over taxpayers. Typically, beneficiaries will be the winners, and taxpayers the losers. Curiously, though, economists have found that elected officials who spearhead fiscal adjustments (a sustained decrease in deficit-to-GDP or debt-to-GDP ratio) are not typically punished at the ballot box.⁸ This is a puzzle until one realizes that fiscal adjustments are “endogenous,” or chosen strategically by politicians. Researchers have also shown that fiscal adjustments are often spurred on by crises, when the public may be willing to accept tough medicine.⁹ So, in the face of an active crisis (or the perception that a crisis is imminent), the political calculi that prevent reform may be adjusted in favor of taxpayers. As I noted earlier, elected officials may have more leeway today than in most years. The public is paying attention to the deficit and believes some action is needed, though just as in Congress, there is disagreement among voters regarding how to achieve fiscal reform.

Keeping Promises

Acknowledgment by Congress and President Obama that creeping fiscal risks have to be addressed, and public agreement in this regard, creates a rare opportunity for change. Without an enforcement mechanism to accompany any reform agreements, there is a significant risk that any promises made today will not be kept tomorrow. Legislators may commit today to cutting spending next year (and the following year, and so on), but when next year comes, legislators and their constituents may value spending over the cut, especially if the cut is painful. In other words, the same pain the legislator is trying to avoid today will manifest itself next year, forcing the same difficult choice. The political reality is that the hard cuts in any plan are usually deferred until well into the future, so the likelihood of long-term agreements having durability in the absence of some external enforcement mechanism is very small.

We can make an analogy to somebody trying to lose ten pounds. This person could write out a plan for doing so, but without some enforcement mechanism, the temptation each day would be to skip a workout or eat that extra piece of dessert. Just as somebody trying to lose weight needs some sort of enforcement mechanism to achieve his or her goal, any agreement on budget reform requires a similar enforcement mechanism.

THE CASE FOR CONSTITUTIONAL CHANGE

⁷ Wilson, James Q. 1980. *The Politics of Regulation*. New York: Basic Books; Lowi, Theodore J. 1964. “American Business, Public Policy, Case-Studies, and Political Theory.” *World Politics* 16:677-693.

⁸ Alesina, Alberto. 2010. “Fiscal Adjustments: What Do We Know and What Are We Doing?” Working Paper No. 10-61, Mercatus Center at George Mason University, available at

<http://mercatus.org/sites/default/files/publication/Fiscal%20Adjustments.%20What%20Do..Corrected%20Table.Alesina.pdf>; Alesina, Alberto, Roberto Perotti, and Jose Tavares. 1998. “The Political Economy of Fiscal Adjustments.”

Brookings Papers on Economic Activity 1998(1):197-266.

⁹ Alesina, Alberto, Silvia Ardagna, and Francesco Trebbi. 2006. “Who Adjusts and When? The Political Economy of Reforms.” *IMF Staff Papers* 53(Special Issue):1-29.

There are many ways to create enforcement mechanisms to ensure that agreements reached today are enforced tomorrow. The House and the Senate can create internal enforcement rules, such as the PAYGO rules passed in 2007. Congress and the president can reach agreement on a statute with enforcement mechanisms, as with Gramm-Rudman-Hollings legislation in the 1980s. Or, these rules can be codified in the Constitution. Constitutional rules are the only ones, however, that are “sticky” in the short-run and therefore immune to the problems that plague internal or statutory rules.

Article I, Section V of the U.S. Constitution establishes why chamber-based and even statutory rules are inferior to Constitutional rules. It states plainly, “Each House may determine the rules of its proceedings.” The implications of this simple statement are profound. Members of Congress can construct their own rules, meaning that they can change their own rules, or even ignore them, as they see fit. The current Congress cannot bind future Congresses. If the goal of a rule is to ensure that deals are kept, some external enforcement mechanism is needed.

Statutes may provide slightly more durability than internal rules, but these can be changed with a simple majority vote if the president chooses not to veto a change. And when Congress is feeling enough pressure from constituents that they want to abrogate a budget agreement, it will be difficult for the president to stand in its way. Historically, we have observed Congress and the president evade or undo rules that proved to be inconvenient. Gramm-Rudman-Hollings and PAYGO are two examples.¹⁰

Constitutional rules are different. Unlike internal or statutory rules, Constitutional rules can only be changed after several significant hurdles are overcome, including either a two-thirds majority in the House and the Senate or a Constitutional convention, either of which would have to be followed by ratification of the change by three-fourths of the states. By contrast, internal or statutory rules can be changed in days, minutes even, if the political will exists. Constitutional rules typically take years to change, and changes are rare, as evidenced by the small number of amendments—27—to the U.S. Constitution. Moreover, the U.S. Supreme Court would be able to intervene if Congress flouted Constitutional budget rules.

Constitutional rules, therefore, provide the means to help keep Congress in check and ensure that fiscal discipline is maintained even when the temptation to abrogate agreements is hard to resist. Statutory rules and internal rules simply do not provide the same level of stability. If Congress is committed to long-term fiscal reform, it ought to propose to the states a Constitutional amendment that creates a framework for fiscal discipline.

GETTING THE RULES RIGHT

The promise of Constitutional rules as enforcement mechanisms lies in their durability. But this durability is also a peril: bad rules can be locked-in just as good rules can be. I will discuss three principles of rule design that will help mitigate this problem.

1. Legislators should design budget rules that are general and apply to the entire federal budget.

A Constitutional rule is meant to be permanent, and as a consequence, it should focus on total federal spending or revenues rather than specific government programs. A Constitutional amendment regarding the Medicare program, for instance, is ill-advised. An amendment that limits the outlays or the revenues of the federal government speaks to a general principle of fiscal responsibility, and it provides the structure for subsequent debates in Congress about how to achieve that principle. Moreover, it prevents legislators from

¹⁰ For a description of the pitfalls of PAYGO, see de Rugy, Veronique, and David Bieler. 2010. “Is PAYGO a No-Go?” Mercatus on Policy No. 73, Mercatus Center at George Mason University, available at http://mercatus.org/sites/default/files/publication/MOP73_PAYGO_web.pdf.

carving out certain programs from this general principle, as is often done today with entitlements like Medicare and Social Security.

2. Legislators should design rules that are precise and prevent the use of loopholes or gimmicks.

Budget rules ostensibly designed to accomplish the same goal, perhaps even with the same name, can have very different effects depending on how they are implemented. Yet, budget rules are often (intentionally) written in vague terms, with the details left to be worked out. Or, the wording of the rule permits evasion relatively easily. The details can make-or-break a rule's effectiveness, since the entire purpose of rules is to encourage elected officials to take actions that they have incentives not to take. Definitions are crucial in this regard. For instance, Congress allowed itself to determine on a case-by-case basis what constituted an emergency that permitted caps on spending or PAYGO laws to be waived.¹¹ Constitutional rules that leave implementation details up to Congress may be eviscerated once the details are worked out.

3. Legislators should design rules with limited, carefully constructed exit options.

While the point of a Constitutional rule is durability, unexpected events require that Congress has the flexibility to, say, fund a war or handle a major emergency. To address such emergencies, most Constitutional budget rule proposals permit waiver of the rule with either a majority, three-fifths, or two-thirds supermajority. These thresholds are problematic because they are no more difficult than passing regular legislation, circumventing a filibuster, or overriding a presidential veto, respectively.

In order to send a signal that Constitutional rules ought to be waived only in extraordinary circumstances, the threshold for waiving the rules should be very high—say, 90% of both chambers. In true emergencies, the Congress would undoubtedly provide needed funds. In order to make the declaration of an emergency transparent, spending made under this provision could be segregated from other spending and be paid back during a set time period—for instance, 10 or 15 years. This would further discourage inappropriate use of waiver provisions.¹²

ARGUMENTS AGAINST CONSTITUTIONAL BUDGET RULES, AND MY REPLIES

Amending the Constitution is a serious—some might even say drastic—step for the country, and there is strong opposition to taking this action on budgetary matters. I will now consider three important arguments against reform and rebut them.

1. **Claim:** A Constitutional amendment is unnecessary since all we need to do to restore fiscal discipline is pass the right kinds of bills.

Reply: In a perfect world, this claim would be absolutely correct. Legislators and the president would come together and agree to binding limits on spending, and then they would live by those agreements. Voters would understand when significant cuts to local projects were required or when Medicare benefits were scaled back. In the real world, however, such agreements are unlikely to survive for more than a few years before elected officials succumb to spending temptations.

¹¹ Saturno, James V. 2007. "Emergency Spending: Statutory and Congressional Rules." CRS Report for Congress, RS21035, July 24.

¹² For several examples of questionable emergency designations, see de Ruyg, Veronique. 2008. "The Never-Ending Emergency: Trends in Supplemental Spending." Mercatus Policy Series Policy Comment No. 18, Mercatus Center at George Mason University, available at http://mercatus.org/sites/default/files/publication/The_Never-Ending_Emergency.pdf.

2. **Claim:** A Constitutional amendment gives too much power to the U.S. Supreme Court over budgetary matters.

Reply: Unless an amendment explicitly rules this out (as some versions of Constitutional budget rules do), the U.S. Supreme Court may adjudicate disputes regarding Constitutional budget rules, and lawsuits challenging Congressional budgets may be commonplace. The end result, some fear, is a budget process that ends each year with the decision of nine unelected justices. This fear is unwarranted, as rule designers can be proactive in limiting judicial overreach. The Supreme Court could be authorized to require only certain sorts of remedies—for instance, the Court could only mandate spending cuts to satisfy a balanced budget rule, not tax increases. Standing of citizens could be limited to avoid frivolous lawsuits. And, the clearer the rule, the less leeway the justices will have in interpreting it. This fear of judicial intervention, in fact, will motivate Congress to take all possible actions to avoid Court involvement in the budget process. Moreover, the Court will be loath to micromanage the budget process, and would most likely simply request that a problematic budget be revised. The hypothetical dangers outlined by critics of Constitutional reform have to be balanced against the very real danger that Congress will not be able to abide by the rules it sets out for itself, or will change them when the going gets tough.

3. **Claim:** A Constitutional budget rule won't solve our fiscal problems, but will merely shift burdens to the states.

Reply: A Constitutional budget rule will certainly force the states to reevaluate their spending habits, but this is a benefit, not a drawback, of such a rule. By placing spending decisions closer to the people who have to bear the costs of those decisions, policy outcomes will tend to be more efficient. Limits on federal spending, and especially aid to the states, will also eliminate incentives for states to overspend. There is extensive evidence in the economics literature for a “flypaper effect,” meaning that federal aid tends to “stick where it hits” and create upward pressure on state spending.¹³ Though there is dispute about the precise size of this flypaper effect, there is little doubt that federal aid creates perverse incentives for the states.

CLOSING

In closing, Congress and the president have a rare opportunity to enact meaningful budget reforms. My fear is that those agreements will ultimately dissolve in the absence of a Constitutional amendment that provides a framework for enforcing those agreements. Constitutional rules, unlike statutory or internal rules, are difficult to change. If written to cover the entire budget, avoid loopholes, and make waivers difficult to obtain, Constitutional rules can provide the enforcement mechanism that will help ensure that specific reforms to entitlements, defense, and other spending areas will not be undone by future Congresses.

Thank you again for inviting me to testify. I welcome your questions.

¹³ For an overview, see Hines, Jr., James R., and Richard H. Thaler. 1995. “Anomalies: The Flypaper Effect.” *Journal of Economic Perspectives* 9(4):217–26; Inman, Robert P. 2008. “The Flypaper Effect.” NBER Working Paper No. 14579.