MAKING BUDGET RULES WORK

BY DAVID M. PRIMO
ABOUT THE MERCATUS CENTER AT GEORGE MASON UNIVERSITY

The Mercatus Center at George Mason University is the world’s premier university source for market-oriented ideas—bridging the gap between academic ideas and real-world problems.

A university-based research center, Mercatus advances knowledge about how markets work to improve people’s lives by training graduate students, conducting research, and applying economics to offer solutions to society’s most pressing problems.

Our mission is to generate knowledge and understanding of the institutions that affect the freedom to prosper and to find sustainable solutions that overcome the barriers preventing individuals from living free, prosperous, and peaceful lives.

Founded in 1980, the Mercatus Center is located on George Mason University’s Arlington campus.

www.mercatus.org

ABOUT THE AUTHOR

David M. Primo is the Ani and Mark Gabrellian Professor and an associate professor of political science and business administration at the University of Rochester, where he serves as the director of graduate studies in the political science department. He is an expert in American politics, campaign finance regulation, and fiscal policy, and his current research focuses on corporate strategy in political and other “nonmarket” environments. Primo is the author of three books, including the award-winning *Rules and Restraint: Government Spending and the Design of Institutions*, and numerous professional journal articles. His op-eds have been published in the *New York Times*, *Wall Street Journal*, and other national newspapers. Primo has testified before Congress on the subject of constitutional budget rules, and his campaign finance research was cited by the US Supreme Court in a 2011 case addressing the public funding of elections. Primo joined the Rochester faculty in 2002 after receiving his PhD from Stanford University.
ABSTRACT

The United States faces severe fiscal challenges that can no longer be ignored. Entitlement spending, especially Medicare, is a ticking time bomb that must be defused. A growing debt burden raises concerns about the government’s ability to pay back debt without strangling economic growth. These threats reflect the inability of legislators and presidents to make the hard choices needed to restore fiscal responsibility to the US system. Legislators face two problems—commitment and enforcement. Legislators cannot make promises today that are credible tomorrow, in part because temptations to spend are always present and electoral considerations tend to favor spending over fiscal discipline. Even worse, attempts to enforce any promises they make are subject to the same credibility problems. In this paper, I argue that well-designed budget rules can help solve these commitment and enforcement problems to create credible and sustainable changes to the federal budget.

JEL codes: H1, H6

Keywords: balanced budgets, government spending, legislatures, budget rules, constitutional amendments, taxation, fiscal policy, debt, deficits
THE US CONGRESS has the constitutionally granted authority to determine its own rules. Members of Congress, even if they are inclined to be fiscally responsible, therefore are hamstrung by their inability to bind future legislators. This flexibility is a curse in fiscal policymaking, because it means promises made today to be fiscally responsible tomorrow are not credible, and that rules constructed to enforce those promises can easily be undone.

Meanwhile, the United States faces severe fiscal challenges that can no longer be ignored. Entitlement spending, especially Medicare, is a ticking time bomb that policymakers must defuse. A growing debt burden raises concerns about the government’s ability to pay back debt without strangling economic growth. These threats reflect the inability of legislators and presidents to make the hard choices needed to restore fiscal responsibility to the US system.

Standard & Poor's, an agency that rates the likelihood that governments will be able to pay back their debt, downgraded US debt in 2011 in part because Congress and the president lacked a “credible solution to the rising US government debt burden and are not likely to achieve one in the foreseeable future.” The key word here is credible, which, as S&P notes, requires an agreement that is sustainable over the long run.¹

Legislators on both sides of the aisle have acknowledged the problem. House Minority Whip Steny Hoyer (D-MD) has written, “The course we’re on will lead to public debt that will exceed the size of our entire economy, and a government that will eventually exist to do only two things: fund entitlement programs and make interest payments.”² House Budget Committee Chairman Paul Ryan, who since 2008 has authored long-term budget-reform plans with the titles “Roadmap for America’s Future” and “The Path to Prosperity,” has noted, “By refusing to tackle the drivers of the nation’s debt…. Washington lurches from crisis to crisis.”³ Many

---

others, including Rep. Justin Amash (R-MI), have proposed constitutional limits on government outlays.\(^4\)

Meanwhile, President Barack Obama has pledged to put the country “on a fiscally sustainable path.”\(^5\) In 2010, he created a National Commission on Fiscal Responsibility and Reform to develop a plan “to improve the fiscal situation in the medium term and to achieve fiscal sustainability over the long run.”\(^6\) The commission’s recommendations, which included significant spending and tax reforms, have languished.

Making matters worse, many prominent voices argue that now is not the time to get the United States’ fiscal house in order, and some academics, such as Nobel Prize–winning economists Robert Solow and Paul Krugman, incorrectly deny that the national debt imposes a serious burden on future generations.\(^7\) Others, like former Federal Reserve vice chairman Alan Blinder, advocate that lawmakers match long-term budget reforms with short-term increases in spending.\(^8\) Declining deficits are also lessening any pressure to act, even though the long-term budget picture is still bleak.\(^9\)

It is not surprising, then, that no major reforms to address long-term problems are on the immediate horizon. It seems that there is never a good time to be fiscally responsible. During the recent recession, many politicians and economists told Americans that stimulus spending was necessary to keep the economy afloat, and that this justified large deficits. Now that the economy is improving, many of them say that the deficit is not a problem. Both of these claims, however, reflect short-term thinking that ignores the need for long-term solutions. This short-term thinking, as I show in this paper, is a function of the incentives facing elected officials.

In this paper, I explain that Congress faces two problems—commitment and enforcement—which prevent well-meaning legislators from effecting change. I then argue that budget rules are one mechanism for addressing both of these problems, but not all rules are created equal. Some, like giving the president a line-item veto, will do little and may even be counterproductive. Others, like a rule limiting increases in spending, are excellent starting points for reform.

This paper proceeds as follows. First I describe the nature of the looming fiscal crisis facing the country. Then I discuss why Congress is having such difficulty...
implementing meaningful budget reform. Next I show why budget rules offer the best prospect for credible, sustainable budget reform. I also propose a set of principles that should guide rule designers at the federal level. I conclude by discussing the potential risks of implementing rules that satisfy these principles.

THE COUNTRY’S LOOMING FISCAL CRISIS

A meaningful discussion about rules cannot occur unless rule designers—typically legislators—acknowledge that current policies are unsustainable. If too few legislators share this perspective, there can be no progress made on rule design. It is useful, therefore, to begin by specifying the nature of the problem that should concern all legislators.

The United States is on a fiscal course toward economic crisis. In all US history up until 2012, the gross federal debt, which includes debt held by the public as well as debt owed internally within the government through accounts like the Social Security Trust Fund, exceeded the nation’s economic output in only three fiscal years—1945 through 1947. In 2012, the gross federal debt hit 103.2 percent of that year’s Gross Domestic Product (GDP) of about $15 trillion. President Obama’s Fiscal Year 2014 budget estimates that the gross federal debt will exceed GDP through 2020. The budget also predicts that the nation’s debt will increase by nearly 60 percent in nominal dollars between FY 2012 and FY 2023, reaching an astonishing $25 trillion. To further place these numbers into context, consider that US federal debt and deficit levels today exceed the targets required by the European Union’s Maastricht Treaty before an EU member can adopt the euro. (Those targets are a gross debt of no more than 60 percent of GDP and a deficit of no more than 3 percent of GDP.)

These high levels of debt carry with them serious consequences. Although there is disagreement about the precise point at which debt begins to stifle growth, the recent European experience demonstrates what happens when creditors lose faith in a country’s ability to make good on its obligations. As the Congressional Budget Office notes, an interest-rate hike would place severe strain on the US government due to increases in interest payments. As the debt outstanding grows, it will of course magnify this effect. Moreover, these figures do not reflect the unfunded

12. Ibid., 227.
liabilities from Social Security and Medicare commitments to current and future participants in these programs.\textsuperscript{14} According to the trustees charged with overseeing these programs, these liabilities exceed $50 trillion in today’s dollars and represent about 4 percent of future GDP.\textsuperscript{15} (By way of comparison, total federal spending today is approximately 23 percent of GDP.)\textsuperscript{16} In other words, it would take $50 trillion right now, given assumptions about the future, to fund these programs into perpetuity (after accounting for the dedicated taxes that would be collected for them under current law).

The situation is even worse if we consider the government’s total liabilities. Economist Laurence J. Kotlikoff and investment strategist Scott Burns estimate that the total unfunded liabilities facing the country are $211 trillion in today’s dollars, or about 14 times the size of GDP. This figure does not include state and local unfunded obligations, such as pensions, which Kotlikoff and Burns estimate to be $38 trillion.\textsuperscript{17}

Kotlikoff and Burns’s estimate is based on the Congressional Budget Office’s alternative fiscal scenario (which accounts for political and other factors in forecasting the likely trajectory of government policy).\textsuperscript{18} The CBO at one time projected that by 2085, federal spending would consume 75 percent of the entire US economy.\textsuperscript{19} In one sense, both the CBO and the Kotlikoff and Burns figures are fantasies, as the United States will never reach this level of debt—the economy would implode long before that happened. Perhaps realizing this, the CBO no longer estimates net debt and associated interest payments once expected net debt exceeds 250 percent of

\textsuperscript{14} Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, \textit{Annual Report} (Washington, DC: Government Printing Office, 2013); Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, \textit{Annual Report} (Washington, DC: Government Printing Office, 2013). There are several parts to the Medicare program, including hospital insurance (Part A), medical insurance (Part B), and prescription drug coverage (Part D). The Medicare Trustees set unfunded obligations for Parts B and D at 0 because they are guaranteed funding from general revenues. However, the portion of Parts B and D that comes out of general revenues can reasonably be construed as an unfunded liability, since payroll taxes are not allocated for this spending (as opposed to Social Security and Medicare’s hospital insurance component, which are funded through dedicated payroll taxes). The data in the current paper treat anticipated funding from general revenues as an unfunded liability.

\textsuperscript{15} These numbers reflect the net present value of unfunded obligations through the infinite horizon, and therefore include current as well as future participants in Medicare and Social Security. Social Security obligations represent 1.4 percent of GDP, and Medicare obligations (treating anticipated funding from general revenues as unfunded liabilities) are 2.7 percent of GDP. For details on Social Security, see p. 17 of the first report referenced in footnote 14, and for details on Medicare, see tables V.G1, V.G3, and V.G5 of the second report referenced in footnote 14.

\textsuperscript{16} OMB, “Summary Tables,” 183.


\textsuperscript{18} Ibid., 238.

GDP; the CBO expects the debt to reach this “milestone” by 2050.\textsuperscript{20} It is the fantastical aspects of these figures that prove their value, however, as a wake-up call that “politics as usual” is no longer viable.

Moreover, the longer we wait, the harder the choices will be. The CBO estimates a figure called the “fiscal gap,” which reflects how much in spending cuts or tax hikes are needed today to maintain current debt-to-GDP ratios. In 2012, the CBO estimated that if action began immediately, the government would have to close a fiscal gap of about 4 percent of GDP under the alternative fiscal scenario. If the country waits until 2025, that gap grows to 10 percent.\textsuperscript{21} Kotlikoff and Burns paint an even starker picture by taking into account total federal liabilities. They estimate that taxes would need to increase by 64 percent or spending would need to decrease by 40 percent today to fully incorporate these liabilities into the budget. Waiting 20 years drives these figures up to 77 percent and 46 percent, respectively.\textsuperscript{22}

To close this fiscal gap, reforms to entitlement programs are a must, and adjustments to tax policy and discretionary-spending programs are also necessary. Otherwise, the federal government will face the grim choice of drowning in interest payments, defaulting on the debt, or “monetizing the debt” (i.e., printing money to pay off a portion of the debt, which would create significant inflation).\textsuperscript{23} It will be difficult to implement the necessary changes to avoid these outcomes—and it will also be difficult to make any substantive reforms stick.

As the next section will show, budget rules can help members of Congress create durable changes to the federal budget.

**CONGRESS’S COMMITMENT PROBLEM**

To understand how rules can help Congress fix the nation’s fiscal problems, we must first identify why Congress struggles with spending, even as many members understand the nature of the problems facing the federal government: Congress’s commitments to responsible budgeting lack credibility. Even legislators who want to reduce the size of the government’s budget, the debt, or the deficit will find it difficult to take actions toward those ends. There is often talk—especially from CEOs—about how politicians just need to get in the same room and work out budget reforms. This


\textsuperscript{21} CBO, *CBO’s 2012 Long-Term Budget Outlook*, pub. no. 4507 (Congressional Budget Office, June 2012), figure 1-3, http://www.cbo.gov/publication/43288. The CBO does not estimate a fiscal gap using the alternative fiscal scenario in its *2013 Long-Term Budget Outlook*.

\textsuperscript{22} Kotlikoff and Burns, *Clash of Generations*, 31.

\textsuperscript{23} However, inflating away the debt by printing money may not be a viable solution for many reasons, including the short-term maturities of current government debt. For a very clear explanation of why bond maturities are important, see John P. Hussman, “Simple Arithmetic,” *Weekly Market Comment*, July 25, 2011, http://www.hussmanfunds.com/wmc/wmc110725.htm.
reflects a fundamental misunderstanding about government. Government is not like a business in which a CEO can unilaterally make decisions in the best interests of the shareholders after receiving input from senior management. Instead, the authorization for any government reform depends on collective decision-making, which typically involves veto players who can stifle reform to protect their own interests. To put this in perspective, imagine a firm that has 535 CEOs who each get a vote on the company’s strategy. That is reality for the US government as it attempts to implement a major reform.

The nature of American democracy intersects with the nature of the nation’s fiscal problems to stack the deck against reform in three ways:

- The growing federal budget and associated increases in deficit and debt levels are “creeping risks.”
- Reelection-motivated politicians are concerned with the short run, not the long run.
- Congress and the president cannot control the actions of future legislators and presidents (including themselves).

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. As enough events occur, the risk ultimately manifests itself in catastrophic ways. For example, one day of unhealthy eating will have a minimal long-term effect on an individual’s health, but years of unhealthy eating may lead to a serious health problem. A broken leg presents an immediate risk; unhealthy eating habits represent a creeping risk. Because of the incentives they face, legislators are much more likely to respond, effectively or not, to the fiscal equivalent of a broken leg than to less immediate concerns.

The World Economic Forum in 2010 identified fiscal crises as one of the major creeping risks facing the world, and the recent debt crisis in Europe is an excellent example of a creeping risk manifesting itself suddenly. The US fiscal situation, though perhaps not as dire as Europe’s recent experience, is headed in the same direction. Because the risks associated with US government debt and spending are developing gradually over time, the short-term costs of ignoring those risks at any given point are minimal—the United States is unlikely to default on its debt by the end of 2014—while the short-term costs, both fiscal and political, of addressing the risks are large.

Factoring in the long run changes the calculus. Unless a sudden debt crisis emerges, the United States may be able to wait a decade to reform entitlement pro-

25. Ibid.
grams, eliminate deficits, and bring down the nation’s debt, but it will be far cheaper and more effective to start now. Moreover, each year of increased spending creates a new baseline for the size of government, increasing expectations about the services the federal government will provide and making reform that much harder to achieve. If one adopts a short-run perspective, then doing nothing may be the most beneficial course of action. But if one considers a long-run perspective, immediate action is necessary.

Unfortunately, short-run considerations tend to dominate in Washington due to the realities of electoral politics. Legislators are ill-equipped to handle creeping risks because the fixes require short-term pain for long-term gain. This trade-off is a difficult sell politically, especially when some politicians and pundits refuse to acknowledge the severity of the risk.26 If the choice is between a big deficit and lots of perks for their districts or a small deficit and sizeable cuts to popular programs, legislators will be hard-pressed to choose the latter. Tough budget votes are difficult to explain to constituents, especially for amorphous goals like reduced government debt.

A 2010 Bloomberg News poll illustrates the nature of the problem. Nearly half the respondents believed that the budget deficit is “dangerously out of control and threatens our economic future,” yet 82 percent were opposed to reductions in Medicare to deal with the problem.27 For politicians who are “single-minded seekers of reelection,” to use political scientist David Mayhew’s famous phrase, numbers like this send a clear message about the rational course of action.28

The politics of deficit reduction and spending cuts, 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 at the ballot box, voters do not normally punish elected officials who spearhead fiscal adjustments (sustained decreases in deficit-to-GDP or debt-to-GDP ratios).29 This is a puzzle until one realizes that fiscal adjustments are “endogenous”—that is, politicians strategically choose if and when to pursue them. Researchers have also shown that economic crises, in which the public may be willing to accept tough medicine, spur fiscal adjustments.30 So, in the face of an active crisis (or the perception that a crisis is imminent), the political calculus preventing reform may change in favor of taxpayers.

Even if the opportunity for fiscal belt-tightening presents itself, the reforms needed to bring spending and debt in line will require years of sustained changes to

government programs, necessitating long-term commitments to fiscal responsibility. Suppose, though, that enough legislators join forces to create a long-term solution to the country’s fiscal problems. While a representative may want to commit today to limiting spending next year (and the following year, and so on), when next year comes, the representative (and his or her constituents) may hesitate to act. In other words, the same pain the legislator is trying to avoid today will manifest itself next year, forcing the same difficult choice. It is possible that the agreement could be made self-enforcing by putting the reforms on “autopilot”—making cuts or tax increases the default option—or by structuring a reform so that future change is difficult. Neither of these approaches, however, would prevent legislators from undoing major reforms piecemeal or turning off the autopilot, as they have done with the “doc fix” that was supposed to limit (or even cut) government payments to physicians to stem the growth of Medicare spending. Meanwhile, some commentators portray the 2013 sequester as evidence that automatic cuts can be effective at cutting spending. While this may be true in the near term, it strains credulity to believe that long-term fiscal reform can occur through automatic budgeting.

**CONGRESS’S ENFORCEMENT PROBLEM**

Congress finds it difficult to commit to fiscal responsibility, then, because the risks of inaction are creeping, tough budget votes are hard to explain to constituents, and a pledge made today will be hard to keep tomorrow. One way to manage Congress’s commitment problem is to specify a rule requiring or prohibiting particular actions. Congress could, for instance, enact a spending cap requiring that spending increase at a rate no greater than inflation or that budgets be balanced each year (or both). In Congress’s case, however, this solution introduces a new problem, constitutional in nature. Article I, section 5 of the US Constitution reads in part, “Each House may determine the rules of its proceedings.” This single line poses a major obstacle for a legislator attempting to manage the commitment problem outlined earlier. It means, in essence, that Congress has extraordinary leeway to write budget rules, even statutory ones, and then choose to change or ignore them. It is the proverbial judge, jury, and executioner.

---

31. The inability of members of Congress to bind future members in the absence of a constitutional rule magnifies this time-consistency problem. The legislators making decisions five years from now may have very different preferences than the members making decisions today. Nobel Prize–winners Finn Kydland and Edward Prescott describe this concern in the context of monetary policy. See Kydland and Prescott, “Rules Rather Than Discretion: The Inconsistency of Optimal Plans,” *Journal of Political Economy* 85 (1977).


There are good reasons for granting the House and Senate so much leeway. One would not want judges or presidents intervening in every legislative dispute over parliamentary procedure, after all. But Article I, section 5 also makes it difficult to construct rules addressing commitment problems, because a determined majority can undo those rules. If the purpose of a rule is to help solve a commitment problem, members must not be able to change or ignore the rule very easily. As Rep. Alcee Hastings (D-FL) bluntly put it, “I wish that I had been there when Thomas Edison made the remark that I think applies here: ‘There ain’t no rules around here—we’re trying to accomplish something.’ And therefore, when the deal goes down, all of this talk about rules, we make ‘em up as we go along.”

Due to this constitutionally granted freedom, Congress will typically need to rely on external rule enforcement. This might occur informally through public opinion and associated electoral threats. If legislators ignore a balanced budget requirement, for instance, public outrage could be so significant that electorally secure incumbents become vulnerable. It may also come from the markets, which could react by driving up interest rates on US debt.

This sort of enforcement is not always reliable, though. Recall the Bloomberg poll referenced earlier, demonstrating the disconnect between attitudes toward overall spending and those toward specific programs. Meanwhile, market punishments tend to be unpredictable and sudden.

A different approach is needed. Specifically, Congress has to relinquish some control over the enforcement of its rules to a third party that can restrain Congress when it refuses to engage in self-restraint. The problem is, just as Congress controls the rules of its proceedings, it controls the enforcement of its rules. So, even if Congress hired an external enforcer, it would have the ability to fire this enforcer. The legislature faces the same commitment problem with regard to rule enforcement as it does with regard to spending restraint. The best way to achieve some measure of external enforcement is via the Constitution. A constitutional rule would be difficult for later Congresses to change, and if the rule were designed properly, other branches of the government could intervene if Congress violated it. This solution is not without risks, though, and in the guidelines that follow, I address both the pros and cons of constitutional rules.

There is an additional advantage to external enforcement. Nobel Prize–winner Thomas Schelling, writing about bargaining power, advocates for binding rules that amount to external enforcement. Schelling famously gives the example of an army burning bridges to signal to opponents that surrender is not an option. Externally enforced budget rules, following the same logic, can transmit information, acting

---


as a signal to outsiders (such as financial markets) that the United States is serious about budget reform. To sum up, a carefully constructed budget rule can help solve Congress’s commitment problem, and external oversight of that rule can help solve its enforcement problem.

**PRINCIPLES FOR EFFECTIVE BUDGET-RULE DESIGN**

Thus far, I have described two interrelated problems facing Congress: a commitment problem and an enforcement problem. Well-constructed rules that are enforced externally can help alleviate both of these problems. So, how should Congress create these rules? Following are 10 actionable principles, tailored to the current fiscal situation, to guide budget-rule design.36

1. **Use Budget Rules to Change the Terms of the Debate**

   It has long been easy for Washington to defer—or simply to avoid—difficult budget decisions. For reasons already discussed, members of Congress have both the incentive and the power to avoid hard budget choices. A budget rule should alter the mindset in Congress away from whether to control the budget and toward how to control the budget. For instance, if a budget rule requires spending cuts for the next decade followed by spending increases at no greater than the rate of inflation, then waiting to act, or debating whether to act, will be off the table. Of course, many members who are unwilling to make hard budgetary decisions will also be unwilling to vote for rules forcing them to make these same hard decisions. However, once enacted, rules can be liberating. If enough electorally secure members had the will to enact a tough rule, that rule could then serve as political cover for other members.

   A bargaining process that begins with both parties knowing that some change to government programs is necessary is very different than one in which keeping the status quo in place is an option. A budget rule like pay-as-you-go (PAYGO), which in theory limits new government programs by requiring them to be offset by equivalent cuts or tax increases, or the line-item veto, which allows the president to eliminate small items in the budget, are not useful for large-scale reform because they do not change the terms of the debate. A member wanting to add new spending to the budget can circumvent PAYGO by finding another budget line to cut or a

---

36. I have previously delineated three principles for rule design—broad scope, few and high-hurdle escape clauses, and limited accounting discretion—as well as three principles for rule enforcement—a credible enforcer, limited enforcement discretion, and embedding the rule in a Constitution. See David M. Primo, “Making Budget Rules Bite” (Mercatus on Policy, Mercatus Center at George Mason University, Arlington, VA, March 2010), http://mercatus.org/sites/default/files/publication/MOP72_Making%20Budget%20Rules%20Bite_web.pdf. While the current paper is organized differently, it reflects all six of these principles.
tax to increase (or simply declaring the spending an “emergency”). In this way, the federal budget can continue to increase dramatically under PAYGO.37 Similarly, the line-item veto will not change the upward trajectory of Medicare or Social Security outlays, since the president can only use it on nonentitlement spending, and any cuts are subject to the approval of Congress. A budget rule that required certain deficit-reduction targets to be met by 2020, on the other hand, would alter how the legislators view the budget process. With such a rule, members would have no choice but to make changes to government programs.

2. Apply Rules Permanently and to the Entire Federal Budget

A temporary budget rule, or one that applies to small parts of the budget, is unlikely to address the nation’s long-run fiscal problems. For decades, Congress has been doing a poor patching job with rules that tinker at the margins (e.g., PAYGO) or that it created to achieve a (relatively) short-term goal (e.g., the Gramm-Rudman-Hollings deficit-reduction legislation of the 1980s). Solutions that have proven effective in small domains for one-time decisions (e.g., the Defense Base Closure and Realignment Commission)38 cannot fix the structural problems in the budget, because future politicians have to be committed to the same structural reforms. Even if Congress does make changes in the short run, the risk of limited reform is that a future Congress will simply revert back to old ways (creating new government programs and running large deficits) once the economy improves. If, instead, Congress creates permanent rules that focus on the entire budget, no spending categories will be off-limits, as they have been in the past.

3. Focus on Spending

One of the most popular budget reforms is a balanced budget rule. It is simple and has intuitive appeal: “My family has to live within its means; why shouldn’t the government?” And it undoubtedly helps prevent massive deficits (though, as the states have learned, not all balanced budget rules are created equal). The problem is, a budget that comprises 40 percent of GDP can be as balanced as a budget that consumes 10 percent of GDP, so long as sufficient revenues are raised. In other words, if a legislator’s goal is to bring spending levels down, a balanced budget rule

37. For an introduction to the problems with PAYGO, see Veronique de Rugy and David Bieler, “Is PAYGO a No-Go?” (Mercatus on Policy, Mercatus Center at George Mason University, Arlington, VA, June 2010), http://mercatus.org/sites/default/files/publication/MOP73PAYGO_web.pdf.
38. For a discussion of this reform, see Jerry Brito, “Running for Cover: The BRAC Commission as a Model for Federal Spending Reform” (Working Paper No. 10-23, Mercatus Center at George Mason University, Arlington, VA, May 2010), http://mercatus.org/sites/default/files/Brito-BRAC.pdf. Note, however, that in the case of base closings, Congress always had the option to reject the recommendations of the commission.
may not be enough. Budget balance (over a multiyear period, at least) is important, but a budget rule should specifically privilege spending restraint over tax increases.

To be sure, tax increases are politically unpopular, so balanced budget rules tend to have a downward effect on spending. My research on state governments has found that states with effectively enforced balanced budget rules spend about 4 percent less than states with balanced budget rules that are not as effectively enforced. 39

A balanced budget rule would probably have a larger effect at the federal level, where no restrictions are currently in place regarding deficit spending. Still, given the size of deficits at the federal level, a balanced budget rule in isolation would probably lead to hefty tax increases alongside spending cuts, and in the long run, spending reductions are more beneficial than tax increases for two reasons. 40

First, compared to a spending cut, a tax increase has a greater potential to produce permanent increases in government spending. To see why, suppose that a government closes its deficit by increasing taxes. Those taxes pay for government programs that typically have narrow constituencies willing to lobby for them. Any attempt to reduce the scope of government will have to overcome this lobbying. Moreover, legislators will be unable to use the budget rule to justify cuts, because the tax increases will already have balanced the budget.

Now suppose that a rule is structured to focus on spending. Surely, there will be a fierce lobbying battle over what gets cut, but something will have to be cut. The spending cut serves two purposes: it reduces both the scope of government and the deficit, assuming taxes are held constant. If the budget rule requires spending cuts that are deep enough, eventually the government will run surpluses, which will justify either tax cuts or a reduction of the national debt. In contrast, a focus on tax increases as an instrument for budgetary responsibility works only on the deficit side, not on the spending side.

The second reason for focusing on spending cuts over tax increases is that they are very likely better for the economy. Economists have shown that spending cuts are associated with higher levels of economic growth, while tax increases are associated with lower levels of economic growth. 41 Though the precise mechanism explaining this relationship is difficult to discern statistically, the following logic is compelling: governments that face the need for fiscal adjustment typically are spending and taxing at excessive levels. A reduction in spending helps bring outlays back to a level that

40. I use the term “cut” here following its (unfortunate) usage in budget debates to refer to both absolute reductions in government spending and reductions in government spending relative to expectations.
reduces the crowding out of private-sector activity without preventing a government from performing tasks that are beneficial for economic growth (e.g., providing for the rule of law, national defense, and basic infrastructure), while tax increases have just the opposite effect.

4. Build Flexibility into Rules by “Smoothing”

Rules that require that yearly targets be met—that a budget be balanced each year or that spending be equal to no more than some percentage of GDP—are inflexible and do not account for the reality that economic downturns or other transitory events may lead to reduced receipts and increased outlays, or that revenue or outlay estimates may be incorrect by small amounts. During a recession, tax receipts typically drop, but many economists would not support the significant tax increases or spending cuts during a recession that a balanced budget rule may require.

One way to deal with this problem (as noted in principle 5, below) is an emergency provision that permits Congress to waive the rule under certain circumstances. This may be necessary in the case of a significant recession or a major war, but for an emergency provision to be taken seriously, it should be used sparingly, not routinely. In many cases, the size of a deficit or the excess spending that occurs in a given year will be small enough that legislators should avoid the use of an emergency provision.

A simple way to avoid overuse of emergency provisions is to tie budget balance or a spending limit to a multiyear period or to long-term economic performance. There are any number of ways to do this. The approach taken in the Amash proposal mentioned in the introduction is to tie spending today to average revenues over the past three years. Rep. Kevin Brady (R-TX) has introduced the Maximizing America’s Prosperity Act, which ties spending caps to potential GDP (a figure that accounts for booms and recessions) as a way to smooth spending over time.

Many European budget rules, including those in Switzerland and, more recently, Germany (which adopted changes to its Constitution that require near-balanced budgets by 2016), permit transitory deficits during recessions but place an upper bound on accumulated deficits. These countries limit “structural” spending based

---


on estimates regarding the state of the economy, taking into account past economic conditions using complicated formulas.

A smoothing approach has many benefits, including flexibility and reduced uncertainty about government budgets. It also prevents sudden changes to government programs, which may produce political backlash. Finally, it increases the rule’s credibility by creating fewer situations where calls for invocation of “emergency” provisions are possible.


Even as legislators create flexibility in rules by “smoothing,” they must also build in some sort of emergency provisions. If the United States were to face a new war, for example, exceeding a spending cap might be justifiable; similarly, if a flu pandemic swept the nation, a widespread government response might be needed.

The risk inherent in this principle is that each year, legislators will come together and find spending they nearly all can agree on. For this reason, Congress should only be able to declare an emergency with a very large supermajority—say, 90 percent. The emergency designation would be good for only one fiscal year, and Congress would have to renew it each year.

To further dissuade overuse of this provision, the government could create a special “emergencies” account which would be the only “off-budget” account permitted under the budget rule. In addition, the funds spent out of that account would have to be paid back using funds taken from general revenues over a fixed time period—say, 10 to 15 years—with revenues necessary for paying down this debt not factoring into budget-rule calculations.45 Having this distinct account would make the specific items legislators are calling emergencies transparent to the public.46

There are several advantages to this approach. First, it requires that emergency spending ultimately fall under the auspices of the budget rule, but at a gradual pace so as not to cause major disruptions. Second, it avoids this account becoming a piggy bank for legislators by setting an extraordinarily high bar for its use and requiring new authorizations each year. Third, it allows the government to pay for emergencies gradually, but forces it to do so in a reasonable amount of time. Fourth, it does not force legislators to mandate significant tax increases or draconian budget cuts when major recessions occur.

45. This prevents the increased revenues needed to pay off the rule from resulting in a permanent rise in government spending.
6. Be Precise to Prevent Loopholes and 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, thereby creating opportunities for subsequent evasion. The details can make or break a rule’s effectiveness, because the entire purpose of rules is to encourage elected officials to take actions that they have incentives not to take. If a group of legislators can find ways to avoid a rule, they are likely to do so. Mercatus scholar Eileen Norcross places these sorts of behaviors into a larger class of activities she refers to as “fiscal evasion.”

Definitions are crucial in this regard, as some real-world and hypothetical examples will demonstrate. Let’s first consider actual rules: Congress allowed a simple majority of legislators to determine on a case-by-case basis what constituted an “emergency” that permitted caps on spending or PAYGO laws to be waived. This is but one of many loopholes and gimmicks in federal budgeting; others include the Social Security “trust fund,” the timing of spending, and the strategic use of budget forecasts.

States act in a similar fashion. For instance, California’s 1979 Proposition 4 (known as the Gann limit) set a cap on expenditures of revenues from taxation. Unfortunately for supporters of the proposition, it defined taxation in such a way that legislators could implement user fees and other “nontax” taxes to skirt the rule. Second, states that wish to get around limitations on “full faith and credit” debt have the option of issuing nonguaranteed debt. More generally, to get around a budget rule, governments can create “off-budget entities,” which are usually not subject to the same debt

---

50. Specifically, the limit defines “proceeds of taxes” as follows: “Proceeds of taxes’ shall include, but not be restricted to, all tax revenues and the proceeds to an entity of government, from (1) regulatory licenses, user charges, and user fees to the extent that those proceeds exceed the costs reasonably borne by that entity in providing the regulation, product, or service, and (2) the investment of tax revenues.” California Constitution, Article XIII(B), § 8(c). The upshot: governments can create user fees for distinct government services and not have them count as taxes, so long as they do not exceed the costs of providing the service. California did just that, and research by Thad Kousser and his colleagues finds that 15 of 23 states that enacted similar tax-and-expenditure limits also saw increases in charges and fees following their enactment. Thad Kousser, Mathew D. McCubbins, and Ellen Moule, “For Whom the TEL Tolls: Can State Tax and Expenditure Limits Effectively Reduce Spending?,” State Politics and Policy Quarterly 8, no. 4 (2008).
and budgeting rules as the creating government. In other words, to get around a limit on government spending, governments classify the spending as something else.

In light of the accounting creativity of elected officials, definitions matter. Yet current proposals suffer from the same problems as actual rules. The Amash proposal mentioned in the introduction defines “total outlays” as “all outlays of the United States except for those for payment of debt.” This definition begs the question, What is an “outlay” of the United States government? For this proposal to have any teeth, it has to define “outlay” very carefully. Yet it leaves the definition up to Congress, so there is nothing to stop legislators from either finding a way to define certain sorts of spending as belonging to a category other than “outlays” or attributing them to some other entity besides the United States government. Such loose language in rules is a serious problem, because it creates opportunities to not only weaken the rules but render them virtually meaningless.

Another fear is that, in reforms that focus directly on limiting spending, legislators will use “tax expenditures” to skirt the caps. A tax expenditure is a deduction, credit, or other tax benefit that directs funds to particular groups. So, if Congress cuts a subsidy to group X from the budget in order to satisfy a spending cap, Congress can still create a tax deduction of an equivalent amount for members of group X. In this way, Congress can satisfy a spending cap while continuing to provide benefits to that group. Tax expenditures are very common already, and their use would likely increase under a typically constructed spending limit. A spending cap tied to long-run budget balance would address this problem.

As these examples demonstrate, wording matters. Because legislators have strong incentives to circumvent the rules, it is important to work out the details at the time of enactment. Leaving these types of decisions for later creates an opportunity to weaken a rule. Important legislation often delegates definitional matters to regulatory agencies and, by extension, courts that rule on challenges to agency rulemaking. There are often legitimate justifications for delegation—expertise of agencies being

51. James T. Bennett and Thomas J. DiLorenzo called this “underground government.” See Bennett and DiLorenzo, Underground Government: The Off-Budget Public Sector (Washington, DC: Cato Institute, 1983). As these authors note, off-budget entities are all around us; just witness the raft of commissions, boards, authorities, and other quasi-governmental groups in most any state.
53. Outlays are currently defined in the U.S. Code (2 U.S.C. § 622) as “expenditures and net lending of funds under budget authority during such year,” with “budget authority” defined at length. New legislation could, of course, change these definitions.
one reason—but in the case of budget rules, delegation to a future Congress is not justifiable.

7. Pay Careful Attention to “Starting Points”

Budget rules related to spending often peg permissible increases to values such as inflation, GDP growth, or population growth. This construction, however, is problematic if at the time of enactment budgets are already at unsustainable levels. For instance, a spending cap for the federal government that permits increases pegged to GDP growth but uses the 2014 budget as a starting point will not be very useful for bringing spending down to pre-stimulus-era levels (assuming this is the goal).

There are two drawbacks to pegging spending to GDP. First, economic growth may not justify an increase in the scope of government. If the economy grows by 10 percent, for instance, it is not clear that defense spending needs to grow by 10 percent. Second, GDP growth fluctuates, leading to problems if spending has to be cut considerably in a year (or multiple years) due to a drop in GDP, or providing opportunities for budget increases if the economy booms over multiple years. For these reasons, a spending cap that initially requires a reduction in spending levels to a prespecified target, and then pegs future increases to inflation with some allowance for population growth, may be more appealing. At a minimum, a cap tied to GDP should have a smoothing mechanism to allow for year-to-year fluctuations in the economy, following principle 4.

8. Fight against Faux Fiscal Discipline and Resist the Temptation to Compromise on Rule Design

Since he took office, President Obama has attempted to claim the mantle of fiscal responsibility in several ways, including by promising to freeze certain kinds of spending for a limited amount of time, imposing PAYGO rules to make it more difficult to create new spending programs, and proposing a line-item veto. These are just three ideas, none of which is unique to this president, that represent faux fiscal discipline. Another stimulus-era proposal would have placed caps on discretionary spending for the next five years. This bipartisan proposal, which did not make it through the legislative process, capped nondefense discretionary spending at over $500 billion for the fiscal years 2010 through 2014, reflecting the then-stimulus-laden budget as a baseline.

Proposals like these may alleviate budgetary stress at the margin, but they fail to address the structural problems in the budget. By claiming that these proposals are steps in the direction of real reform, politicians contribute to the public’s misunderstanding of budget issues. Legislators who are serious about dealing with the federal government’s enormous fiscal problems, then, should make it clear that the United States needs stronger fiscal medicine.

More importantly, legislators should also resist the temptation to compromise on rule design. Many practitioners will question this prescription, noting that politics is about compromise and “the art of the possible.” In some cases, this may be true. But in the area of budget rules, a compromise has dangerous consequences for several reasons. First, one reason a legislator requests a compromise on the design of a rule is to weaken the rule or create loopholes, and such a compromise can be enough to render a rule ineffective. A compromise of the form “let’s cut spending by 20 percent instead of 25 percent” is one thing. But a compromise that exempts certain spending from a rule should be rejected, for the reason discussed earlier. Second, an ineffective budget rule may hamper the efforts of legislators who wish to enact tougher rules in the future, as opponents could point to the existing rule and argue that no further reform is needed. Third, if a budget rule that is ineffective due to political compromise enters into the Constitution, it will be difficult to change.

9. Use a Commission as a Supplement to, Not a Replacement for, a Budget Rule

The budget rules I have discussed do not help Congress decide where to cut the budget. This is where a commission may prove useful. A typical view of commissions is that they, along with committees, are where issues go to die. Bills languish in committee, and commission reports gather dust in an archive. Typically, though, commissions are not dealing with issues on which immediate action is required. So, when commissions come back to the president or Congress with politically unpopular proposals, they can safely be ignored. Suppose, however, that some action is required on an issue. In this case, the commission’s proposals can serve as a starting point for negotiation. A budget rule can require action on spending or deficits, and in this way give a commission’s proposals some heft.

Consider the recent, failed “Simpson-Bowles Commission” addressing the deficit. Erskine Bowles and Alan Simpson have attracted attention and been effective advocates for their approach, but while members of Congress have used their report as a template for proposals, not much has come of it. Lawmakers might have viewed the commission’s work very differently, however, if an existing budget rule

required some spending cuts or deficit reduction. If members of Congress must make cuts, a commission may provide them with the political cover to do so, and also may help them prioritize among government programs.\textsuperscript{58}

10. Incorporate Well-Designed Budget Rules into the US Constitution

In this paper, the focus is on the US Constitution. Amending the US Constitution is a serious matter that should not be undertaken as a substitute for legislation. Because budget rules relate to a fundamental, constitutionally granted congressional prerogative—the power of the purse—and because self-enforcing rules face special challenges in Congress due to the constitutional leeway provided to legislators with regard to rules, constitutional budget rules deserve careful consideration.

If members are able to agree on a rule that requires them to take tough actions, they still need to give the rule bite. Unlike a statute, which a determined Congress can easily change, a constitutional budget rule would require years to change. Members who wished to evade a constitutional rule would not have the luxury of altering it on the fly.

This relative inflexibility is both a blessing and a curse. If well designed, the rule will have an important positive impact. If poorly designed, however, it may negatively influence the budget process for many years, as mentioned earlier. For this reason, it is better to have no constitutional amendment than an easily evaded or poorly constructed one.\textsuperscript{59}

Suppose members can agree on a robust budget rule that helps solve Congress's commitment problem. Will the same rule help Congress solve its enforcement problem? A constitutional rule would raise the specter of Supreme Court (and even presidential) intervention in budgets unless those interventions are specifically prohibited in its text. One also has to wonder whether the enforcer can be trusted. Will the Supreme Court, for instance, overstep its bounds on budgetary matters? This is always a risk.

Robert Bork, in criticizing proposals to enshrine budget rules in the Constitution, writes,

\begin{quote}
Since economists are in the forefront of those advocating constitutional economics, it may be thought ironic that so little attention has apparently been paid to the institutional problems involved, including the incentive structure that judges face and how that structure may influence their interpretations of law.
\end{quote}

\textsuperscript{58} See Brito, “Running for Cover.”

\textsuperscript{59} Because past congressional attempts at constitutional budget rules were typically filled with loopholes, I propose in my book \textit{Rules and Restraint} that the states call for a constitutional convention to create a constitutional budget rule. This approach would not be necessary, of course, if pressure on Congress led it to create a well-designed budget rule.
Having identified the incentive structure confronting legislators as the source of the problem, it is odd that economists should advocate moving the policy into the courts without a similar inquiry. The defects of the legislative process do not of themselves render the judicial process perfect or even preferable.⁶⁰

Another issue is more practical. Namely, will the budget process devolve into chaos, with lawsuit after lawsuit stymieing the legislative process?⁶¹ On this issue, Bork writes,

Also troubling is the problem of enforcing such a constitutional provision. In the early stages of discussion, a lot of people, including most economists, apparently thought this was no problem: if Congress exceeded the constitutional limits on spending, someone would sue. That much is true. The result, however, would likely be hundreds, if not thousands, of lawsuits around the country, many of them on inconsistent theories and providing inconsistent results. By the time the Supreme Court straightened the whole matter out, the budget in question would be at least four years out of date and lawsuits involving the next three fiscal years would be slowly climbing toward the Supreme Court. It is quite possible that it would be necessary to narrow the class of possible plaintiffs significantly and to create a special, and final, court to handle this litigation. Unless attention is paid to the institutional problems involved, a constitutional amendment would become in practice a nullity—either that, or the budgetary process would pass into the hands of the courts, an outcome desired by no one.⁶²

While Bork is correct that one ought to treat judges as strategic actors and that court enforcement would not be perfect, the experience in the US states, nearly all of which have constitutional balanced budget rules, does not suggest gridlock each year due to a rash of lawsuits. Moreover, state constitutions are much more likely to read like statute books, with state constitutions averaging well over 100 amendments. The more detailed a constitution, the more likely its provisions are to conflict, and therefore to admit judicial interpretation. For instance, a Nevada court set aside a supermajority budget rule because it was delaying the passage of

---

⁶¹ Others have raised the concern that nobody will, in fact, have standing to sue if the rule is violated. See, for example, Hearing Before the Subcommittee on the Constitution, Civil Rights, and Human Rights, Senate Committee on the Judiciary, 112th Cong. (2011) (“A Balanced Budget Amendment: The Perils of Constitutionalizing the Budget Debate,” testimony of Alan B. Morrison).
education funding, which the court ruled violated another provision in the constitution regarding a guaranteed education.63

Fortunately, rule designers can be proactive in limiting judicial overreach. The rule could authorize courts to require only certain sorts of remedies—for instance, a court could mandate only spending cuts, not tax increases, to satisfy a balanced budget rule. The rule could also limit standing, in order to avoid frivolous lawsuits. And the clearer a rule is, the less leeway the courts will have in interpreting it.

Constitutional scholar Kathleen Sullivan, a skeptic of amending the US Constitution, notes that the Constitution’s strength lies in its generality. A rule that is too specific, Sullivan points out, is unlikely to capture all contingencies, and it is better to let judges and legislators address issues with an amendment as unanticipated events arise. On the other hand, Sullivan points out, a general budget rule may lead to constitutional conflicts, with the president or the courts arrogating authority over budgetary matters, using the amendment as justification.64

We should consider implementation issues in any constitutional budget rule, but we should also balance the hypothetical dangers that critics of constitutional reform outline 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.65 There is ample evidence historically that Congress will do just that.66 For instance, when it became clear that Congress would not be able to meet the deficit-reduction targets set out in the 1985 Gramm-Rudman-Hollings legislation, it scuttled the law rather than make the required spending cuts.

While constitutional rules are far from perfect, the alternative—self-enforcement—is a proven failure. Constitutional rules, on the other hand, can help Congress address both its commitment problem and its enforcement problem. The fears of overzealous courts or messy legal battles may in fact serve as a further incentive for adherence to budget rules.

Some scholars argue that such constitutional rules are destined to fail, because rules can really only enforce an existing consensus and cannot create one where it does not exist.67 These scholars, of course, must give examples of nonconstitutional rules, because the federal government does not have constitutional budget rules.

It is the weakness of nonconstitutional process reform that makes constitutional rules all the more important. Alice Rivlin, a budget director for President

66. For further details about enforcement challenges, see Primo, Rules and Restraint.
67. See, for example, Wallach, “The Perils of Automatic Budgeting.”
Bill Clinton, while not advocating constitutional reform, is skeptical that standard process reform can force agreement: “A better budget process will not make budget decisions easy or create the will to compromise and solve problems. . . . Process can either hamper decision-making or facilitate it, but only at the margins. . . . No process will work well unless the participants in the process want it to work.” And this is precisely the point of constitutional rules—to force change when politics makes change difficult. Just ask state and local governments, which ultimately come far closer to budget balance than the federal government.

PRINCIPLES SUMMARY

To summarize, then, budget-rule designers should adhere to the following principles:

1. Use budget rules to change the terms of the debate.
2. Apply rules permanently and to the entire federal budget.
3. Focus on spending.
4. Build flexibility into rules by “smoothing.”
5. Build flexibility into rules by incorporating limited, carefully constructed emergency provisions.
6. Be precise to prevent loopholes and gimmicks.
7. Pay careful attention to “starting points.”
8. Fight against faux fiscal discipline and resist the temptation to compromise on rule design.
9. Use a commission as a supplement to, not a replacement for, a budget rule.
10. Incorporate well-designed budget rules into the US Constitution.

Rule designers should use the guidelines provided in this paper to design and improve budget-rule proposals. To show how this might be done, the table on page 29 presents a constructive critique of a proposal by Rep. Justin Amash on the dimensions I laid out. Rep. Amash’s proposal has evolved over time, and I focus on his initial proposal (H.J.Res. 73, 112th Congress). Subsequent proposals have, among other changes, reduced the supermajority for rule waiver from three-fourths to two-thirds.

which treats waivers like an ordinary piece of legislation. The initial proposal is therefore preferable.70

One aspect of the rule necessitates discussion beyond the analysis in the table, and that is how the rule satisfies the principle of focusing on spending. Section 1 of the proposal satisfies this principle by tying spending today to revenues in the past. In other words, tax policy in previous years determines the maximum size of spending today. So, if spending on government programs threatens to exceed the cap, tax increases will not help, because the cap is based on previous revenues; instead, spending must be cut. Similarly, a legislator who wants to create a new government program or fund a new project today cannot do so by raising taxes, because those additional revenues will not factor into the spending-limit calculation until the following fiscal year.

POTENTIAL PROBLEMS WITH STRICT BUDGET RULES

The discussion about constitutional reform points to a more general issue: even if legislators take into account all the suggestions in this paper, problems are still likely to arise as a result of strict budget rules being enacted. First, there will undoubtedly be some loophole or gimmick that legislators will construct in response to the rule. However, if the rule’s designers have followed the principles above, that will minimize the effect of these loopholes.

Second, if a budget rule forces dramatic cuts at the federal level, legislators may simply impose more responsibilities on the states—for instance, by cutting a politically popular program and placing pressure on the states to fund it, or by changing a “matching” agreement to reduce the federal component. There may be a silver lining to any action of this sort. Specifically, shifting expenses to the states internalizes costs to a greater degree, which inhibits the overspending induced when legislators can impose the costs of spending benefitting their jurisdiction on others.

Third, legislators could choose to shift spending burdens to the private sector with increased regulations.71 This is certainly true, but recent reforms to the healthcare system, and any number of other current regulations, demonstrate that this already occurs in significant ways even without such a rule. Moreover, political realities will place limits on the ability of the government to shift burdens further onto the private sector.

Fourth, severe disruptions could result from dramatic and sudden cuts made to satisfy a budget rule. This potential problem reinforces the need to bring new budget rules into force immediately but gradually, thereby preventing an artificial crisis caused by a sudden change in policy, but at the same time giving policymakers

a chance to make changes before a market-driven crisis hits. The alternative—waiting until that market-driven crisis hits—would have far more severe consequences, such as hyperinflation and the potential collapse of the market for US debt.

CONCLUSION

Major adjustments to the federal budget are necessary to stanch the increase in the federal debt and reduce the deficit without hurting the economy. Incremental steps in the budgetary arena have achieved little, and the United States needs more dramatic action. By implementing new budget rules today, legislators can help force hard decisions tomorrow. No budget rule will be perfect, and problems will undoubtedly arise from any rule enacted through the legislative process. Inaction, though, is simply not a reasonable option any longer.

As recent debates have shown, meaningful budget reform faces an uphill battle in Washington. That said, few believed that a Republican president would usher in prescription drug coverage under Medicare, as President Bush did in 2003, or that a Democratic president and a Republican House speaker with vigorous differences would work together to balance the federal budget, as Bill Clinton and Newt Gingrich did in the 1990s. When the next political window of opportunity opens, this paper can help guide policymakers as they design budget rules that will help restore fiscal responsibility to the federal budget process.
### Analysis of Amash Constitutional Budget Rule

<table>
<thead>
<tr>
<th>Resolution Text (Amash)</th>
<th>Plain English (Amash)</th>
<th>Analysis (Primo)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SECTION 1.</strong> Total outlays for a year shall not exceed the average annual revenue collected in the three prior years, adjusted in proportion to changes in population and inflation. Total outlays shall include all outlays of the United States except those for payment of debt, and revenue shall include all revenue of the United States except that derived from borrowing.</td>
<td>Spending = average of prior years' revenues (average revenue of previous three years, adjusted for population changes and inflation) “Outlays” includes everything but debt reduction. “Revenue” does not include borrowing.</td>
<td>Pro: Focus on spending (see main text of the paper for explanation) Flexible by “smoothing” Focus on entire federal budget Permanent Con: Terms like “outlays” are not defined</td>
</tr>
<tr>
<td><strong>SECTION 2.</strong> Three-fourths of the whole number of each House of Congress may by roll call vote to declare an emergency and provide by law for specific outlays in excess of the limit in section 1. The declaration shall specify reasons for the emergency designation and shall limit the period in which outlays may exceed the limit in section 1 to no longer than one year.</td>
<td>Emergency outlays beyond the spending limit (1) require three-fourths support, (2) require a detailed emergency declaration, and (3) only last one year at a time.</td>
<td>Pro: High threshold for waiving rule Limits on length of emergency designation Con: Payoff timetable not specified</td>
</tr>
<tr>
<td><strong>SECTION 3.</strong> All revenue in excess of outlays shall reduce the debt of the United States. Upon the retirement of such debt, revenue in excess of outlays shall be held by the Treasury to be used as specified in section 2.</td>
<td>Surpluses pay off the debt. When the debt is gone, surpluses go into a “rainy day” fund for emergencies.</td>
<td>Pro: Clarifies what happens to surpluses</td>
</tr>
<tr>
<td><strong>SECTION 4.</strong> The Congress shall have power to enforce and implement this article by appropriate legislation.</td>
<td>Reasonable implementing legislation is authorized.</td>
<td>Con: Leaves too many enforcement details to Congress</td>
</tr>
<tr>
<td><strong>SECTION 5.</strong> This article shall take effect in the first year beginning at least 90 days following ratification, except that outlays shall not surpass the sum of the limit described in section 1 and the following portion of the prior year’s outlays exceeding that limit (excepting emergency outlays as provided for in section 2): nine-tenths in the first year, eight-ninths in the second, seven-eighths in the third, six-sevenths in the fourth, five-sixths in the fifth, four-fifths in the sixth, three-fourths in the seventh, two-thirds in the eighth, one-half in the ninth, and the limit shall bind in the tenth year and thereafter.</td>
<td>Gradual ten-year transition. Begins the year (fiscal or calendar) starting 90 days after ratification: provides time for [drafting] implementing legislation . . . &amp; deliberation on policy changes. Initial gap between ratification-year spending and limit reduced at least 1/10th each year. Faster convergence allowed; progress locked in. Emergency spending doesn’t affect baseline.</td>
<td>Pro: Transition rule pays careful attention to starting points</td>
</tr>
</tbody>
</table>