Senator Dick Durbin
Senate Judiciary Committee Hearing on "Preventing America's Looming Fiscal Crisis: the Need for a Balanced Budget Amendment to the Constitution"
Questions for the Record

<u>Questions for Mr. Greenstein</u>

1. Mr. Greenstein, S. J. Res. 6 would require that every year federal government outlays must not exceed receipts. Social Security is one example of a federal program that would be severely impacted by this requirement because Social Security builds up reserves over time in order to ensure that benefits are paid in the current year. Under this balanced budget amendment, Social Security payments could be challenged as unconstitutional unless there were offsetting revenues elsewhere in the budget that year – even if the Social Security Trust Fund had huge reserves.

   There are other federal programs that would be seriously affected by this annual balancing requirement. For example, the military retirement system provides monthly compensation and benefits for over two million military retirees and eligible survivors. The military retirement system also operates on a trust fund system, but could not use surplus reserves to pay annual benefits under a balanced budget amendment.

   Mr. Greenstein, would a balanced budget amendment endanger Social Security and our nation's military retirement system? How about our system of FDIC insurance for bank deposits? What about other middle-class programs like Medicare?

A balanced budget constitutional amendment could seriously disrupt Social Security and the military retirement system. By design, the trust funds for Social Security, military retirement, and civil service retirement are now building up reserves — in the form of Treasury securities backed by the full faith and credit of the United States — which will be drawn down to help pay benefits when the number of retired "baby boomers" climbs higher in the 2020s and early 2030s.

However, under the balanced budget amendment, it would in effect be unconstitutional for these programs to draw down these savings to pay promised benefits, unless the rest of the federal budget ran an offsetting surplus (or if the House and Senate each mustered two-thirds or three-fifths votes to permit an unbalanced budget). Otherwise, benefits would have to be cut, because all spending — including Social Security benefits — would have to be covered by tax revenues collected during that same year. Essentially, a balanced budget constitutional amendment could well result in retirement benefit cuts for seniors and for military retirees, as well as beneficiaries of other trust funds that are designed to build up reserves for future needs: Medicare Hospital Insurance (Part A), Unemployment Insurance, federal employee health and life insurance, and veterans' life insurance, for example.

The potential effects on the banking system also are cause for concern. The Federal Deposit Insurance Corporation (FDIC) currently holds more than $60 billion of reserves, in the form of Treasury securities, to insure depositors' savings. These reserves are called upon when banks fail. The balanced budget amendment would effectively make it unconstitutional for the FDIC to use its assets to pay deposit or pension insurance, since doing so would generally constitute "deficit spending," unless it were contemporaneously offset. In general, a constitutional requirement that all spending during a given year be covered by tax revenues collected in the same year would undercut all U.S. government insurance and loan guarantees — including the "full faith" backing by the U.S. government to pay interest on Treasury securities as well as deposit insurance, pension insurance, FHA loans, small business loans, and so on.

No state, city, business, or family operates under such a severe restriction. Even a state, city, business, or family that *never* borrowed in any form (no bonds, no mortgages, no student loans, no credit cards) could use income saved from previous years to make necessary payments in the current year. But using savings would not be allowed under a constitutional balanced budget amendment, which requires payments in any year to be covered only by *that* year's tax revenue, not by amounts previously saved.

2. It is important to consider the increased burdens that a federal balanced budget amendment would impose on the states.

   On March 16, a group of eight leading economists, including four Nobel Laureates, sent a letter to Congress opposing a balanced budget amendment as a "very unsound policy." Among the concerns listed in the letter was the following:

   > "A balanced budget amendment would invite Congress to enact unfunded mandates, requiring states, localities, and private businesses to do what it cannot finance itself."

   Also, the Congressional Research Service said in an August 2011 report on balanced budget amendments that:

   > "There is also some concern that if a federal balanced budget requirement caused significant cuts in federal programs, that at least some states would find it necessary to make compensatory increases in their own spending, regardless of whether such expenditures were mandated by the federal government."

   Mr. Greenstein, can you elaborate on how a constitutional balanced budget amendment would potentially have a harmful fiscal impact on the states?

   A constitutional balanced budget amendment would amplify the budget pressure already faced by states during difficult economic times. States' balanced budget requirements already force them to cut spending and/or raise taxes during recessions, when tax receipts shrink. Federal fiscal relief plays a crucial role in cushioning the blow to state budgets, allowing them to avoid deep cuts or steep tax increases at the very moment when their economies are least equipped to bear them.

   When the economy weakens, state revenue — like federal revenue — suffers. And as unemployment rises, demand increases for need-based services and programs funded fully or partially by states, including Medicaid. Other pressures on state budgets also mount, such as increased demand for higher education from laid-off workers and other working-age people seeking additional training and credentials at a time when the labor market is especially challenging.

This combination of increased needs and decreased resources can put intense fiscal pressure on states because they are required to balance their operating budgets regardless of economic conditions. A constitutional balanced budget amendment would effectively prevent the federal government from providing fiscal relief to states at the very moment when state budgets and state economies need it the most.

The federal response to the Great Recession provides an apt example of how federal fiscal relief can cushion the blow of weakened or contracting growth on state budgets. The recession sharply reduced state revenues, causing budget shortfalls totaling well over half a trillion dollars. The federal Recovery Act, enacted in early 2009, provided states with temporary aid that was enormously helpful in allowing states to avert some of the most harmful potential spending cuts in the early years after the recession hit. States used this temporary federal aid to close about a quarter of their budget shortfalls over the first four years of the recession. Then, in fiscal year 2012, with federal aid (and state reserve funds) largely depleted, states enacted nearly $140 billion in budget cuts, almost as much as the combined total for the previous four years.

A separate question concerns unfunded mandates on states, localities, and businesses. If it had to balance its budget every year, the federal government would likely try to ease the challenge of meeting this requirement by shifting some of its responsibilities to states, local governments, or businesses. If this occurs, those entities would have to raise taxes (state and local governments) or prices (businesses) to cover the mandates on them, or reduce spending for other services that address state needs. It is worth noting that relying on higher state revenues and higher consumer prices is a more regressive way to pay for these services than federal taxes, which remain somewhat progressive overall. Thus, the threat of mandates in lieu of federal program spending is not just that mandates would misdirect accountability, but also that they shift the burden of meeting national needs to the middle class and those who are poorer, and away from the wealthy.