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Chairman Durbin, members of the Committee, I am honored to be invited to testify before you today on the subject of the advantages of a balanced budget amendment. I am a senior fellow at the Manhattan Institute. From 2003 until April 2005 I was chief economist at the U.S. Department of Labor. From 2001 until 2002 I served at the Council of Economic Advisers as chief of staff. I have served as Deputy Executive Secretary of the Domestic Policy Council under President George H.W. Bush and as an economist on the staff of President Reagan's Council of Economic Advisers.

With the Super Committee failing to cut spending by $1.2 trillion over the next decade, there is no better time to examine the federal budget process.

The deficit for fiscal year 2011 reached $1.3 trillion. According to the Congressional Budget Office, the deficits as a percentage of GDP for 2009, 2010 and 2011 have been the largest since the end of World War II.

One approach is to raise additional tax revenue to bridge the gap. President Obama proposed a five percent surtax on millionaires as part of the American Jobs Act. That bill was defeated in the Senate on October 11.

In September the president proposed raising the two top brackets to 2000 levels, which would have affected individuals with taxable income over $200,000 and joint filers with over $250,000—despite making the case to the country in December 2010 that these tax rates should stay at current levels. This proposal is not being actively considered by Congress at present.

Another approach is to cut spending. The budget resolution passed by the House of Representatives for fiscal year 2012 would cut $6 trillion from spending over the next decade, and bring outlays to 2008 levels. But the Senate has failed to pass a budget for over two years.

Budget reform would make it more difficult for Congress to spend taxpayer dollars. Currently few limits exist on congressional spending, and Congress finds innumerable ways to get around its self-imposed rules.

Corporations may be evil, according to the Occupy Wall Street crowd, but at least they have to stick to a budget. Their accounts must adhere to Generally

Accepted Accounting Principles, or GAAP. Shareholders, accounting firms, and the Internal Revenue Service carefully review different sets of books. No corporation would be able to get away with the accounting practices used by Uncle Sam.

One example of a budget gimmick that recently made news is the Community Living Assistance Services and Supports program, the CLASS Act, a long-term care insurance program passed as part of the new health care law. Since payouts from the CLASS Act would have started five years after the program began collecting insurance premiums, the program showed a net gain of $86 billion in the decade 2010 to 2020. This "gain" lowered the cost of the new health care law within the ten-year window required for scoring revenue effects of legislation.

The program would have lost money in subsequent decades because the premiums collected would not have covered the expenses from long-term care for the beneficiaries. The Department of Health and Human Services Secretary Katherine Sibelius admitted on October 14 that HHS actuaries could not find a way to make the program fiscally solvent, so she was ending the program. The way the program was originally scored made it look like a revenue raiser, but in the long run it would have been a drain on the budget. Now, the health care plan will appear to cost more over the next decade.

Senator Jeff Sessions (R-AL), ranking member of the Senate Budget Committee, told me in a telephone conversation on October 14, "In a time of debt crisis, Congress first has to have a budget, then has to adhere to that budget. It's been almost 900 days since the Senate last passed a budget."

Mr. Sessions, in a bill cosponsored by Senator Olympia Snowe (R-ME) called the Honest Budget Act, has proposed changes to the budget process to try to limit congressional budgeting gimmicks. Since 2005, Congress has spent more than $350 billion using the maneuvers outlined in his bill, according to estimates by the Congressional Budget Office and the Office of Management and Budget.

The Honest Budget Act contains eminently sensible suggestions to improve the budget process, such as scoring transfers from general revenues to the Highway Trust Fund; scoring emergency funding; including the probability of lender defaults in federal loan guarantees; and tying appropriations to a budget passed by Congress.

A balanced budget amendment would be a more substantial change. Such fundamental budget process reform would stem the tide of red deficit ink spewing from Washington.

Congress has considered many balanced budget amendments in the past. These are summarized in a recent study by the Congressional Research Service.[1] Versions in nine congressional sessions did not pass either chamber. The Senate approved one in 1982, sponsored by South Carolina Senator Strom Thurmond. The House passed one in 1995, sponsored by Texas Representative Joe Barton. In each instance, the sponsor was a Republican and the GOP had a majority.

If our politicians were able to craft series of budgets on their own that did not result in continually wider deficits, a balanced budget amendment to the constitution would not be necessary. But the budget process has broken down. The deficit is at $1.3 trillion this year, or 8.7 percent of GDP. Total outstanding public debt is projected to be 100 percent of GDP this year.

Imagine that the balanced amendments of 1982 and 1995 had passed both chambers of Congress and had gone on to be ratified by three-quarters of the states. Today America would have been in a far stronger fiscal position. No trillion dollar deficits, no 100 percent levels of gross public debt.

Everyone prefers politicians to restrain government spending through the existing budget process. But politicians appear to be incapable of doing so, not just in the United States, but also in many European countries, which has led to the current crisis in the Eurozone. States, which are not allowed to run deficits, manage to balance their budgets. Even with its imperfections, a balanced-budget amendment would be a step in the right direction, an improvement on what we have now.

Balanced budget amendments proposed in the 112th Congress come in several versions.

H.J. Res. 1 in the House and S.J. Res. 10 in the Senate would require the president to submit a balanced budget to Congress every year, and would cap spending both relative to a measure of revenues, and as a percent of economic output. Both Senate and House versions call for a supermajority of three-fifths or two-thirds of members to vote for spending and debt above pre-set levels, as well as to approve tax increases.

If each chamber gives a two-thirds supermajority to the proposed balanced budget amendment, it then goes to the states for approval. Approval by three-fourths of them, or 38, is necessary. The most recent amendment, the twenty-seventh, was ratified in 1992, and holds that salary increases for members of Congress can take effect only at the start of the next House term.

[1] James V. Saturno and Megan Suzanne Lynch, "A Balanced Budget Constitutional Amendment: Background and Congressional Options," Congressional Research Service, July 8, 2011.

Under the balanced budget amendments under consideration in this Congress, a three-fifths majority of all members in each chamber would be required to increase the public debt, or authorize additional spending over what had been specified.

Revenue increases by virtue of tax legislation and any outlays above 18 percent of economic product would have to be approved by two-thirds of all members of each chamber.

One can quibble with details of this proposed constitutional amendment, but the philosophy behind it is laudable.

A balanced budget amendment would impose spending discipline, and would protect the American economy against the down-to-the wire bargaining over spending and taxes that is a habitual feature of our budget process.

And it is clear that America is in disarray. Just look at the headlines in last week's papers, with the failure of the Super Committee, and the ensuing fall in stock markets. Or the headlines last December, when taxpayers did not know what tax rates they would face on January 1. Although a two-year tax package was passed at the end of 2010, some members of Congress are today trying to revisit tax hikes. Is this any way to run America?

Additional certainty about fiscal policy would make investment and consumption decisions easier, and would facilitate economic growth and job creation. With unemployment at 9 percent, after cumulative deficits of trillions of dollars, we clearly need another path.

What we have seen since World War II is that the government is profligate and incapable of disciplining itself when it comes to spending. It writes laws that lead to increased spending over time without further congressional action, so-called entitlements such as Medicare and food stamps.

There are significant differences between the House and the Senate versions of the Balanced Budget Amendment, and, of the two, the Senate version is more practical.

The House version uses "economic output" as a base to calculate outlays. "Economic output" is poorly-defined. The Senate version uses gross domestic product. Although GDP is not defined in law, the Department of Commerce has a standard published measure, which is used by the Congressional Budget Office and the Office of Management and Budget.

The House amendment limits outlays to 18 percent of current economic output, making it difficult to know the precise target at the time that Congress is fashioning the budget. In the House version, the balanced budget amendment depends on the accuracy of forecasters. If revenues or GDP fall below forecast, the amendment might be violated—with no mechanism to cut back excess spending. For that reason, critics of such an amendment portray it as more symbolic than binding.

In contrast, the Senate version ties outlays to 18 percent of GDP in the prior calendar year. Hence, the budget now under construction would be based on GDP in 2010.

The final GDP figure for calendar year 2010 was only available in March 2011. This timing is adequate for Congress, but not for the president, who sends his budget to Congress the first week in February. The president starts working on the FY 2012 budget in the fall of 2010, when even third quarter GDP is unknown. But if the FY 2012 budget were based on GDP in calendar year 2009, guidelines and limits would be clear to the president as well as to Congress.

Another way of structuring a balanced budget amendment would be to tie spending in a given year to revenues three years earlier, or some multiple of revenues three years earlier. This would mean that the president and Congress would know in advance unequivocally how much money to spend. It would know that it could not spend more than revenues from calendar year 2009, which ended December 31, 2009.

Pegging spending to a measure of revenues three years earlier might reduce Congress's incentive to raise taxes, because additional revenue could be spent only three years in the future. This would always be after the next election for members of the House of Representatives. So, even if two-thirds of members wanted to raise taxes, they could not spend the money right away, giving them a disincentive to raise taxes for pet projects in their districts or at the request of lobbyists who might be contributing to their campaigns.

In addition, both measures would not allow spending in a fiscal year to exceed projected receipts for that fiscal year. This is difficult to calculate, and should be changed to actual receipts two years back.

In the absence of a recession, receipts as a percent of GDP have generally exceeded 18 percent, so the binding constraint on spending would be 18 percent of revenues collected in the prior year, or prior two years.

However, in a recession year, such as 2010, when receipts as a percent of GDP were 15 percent, this would prevent counter-cyclical spending on unemployment benefits, Medicaid, Food Stamps, and other safety net measures unless two-thirds of members were convinced that additional spending was necessary.

One modification might be to have a "rainy day fund" that is exempt from the limits, and that could be set aside for recessions. As the amendments are worded, there is no provision for spending such funds because outlays are generally limited to 18 percent of GDP and to outlays in a particular year.

The rainy day fund for recessions could be set aside from surplus funds in high-growth periods, just as states reserve rainy day funds. If deficit spending in a recession is discouraged for the federal government, just as it is for states, then the government should be provided with a way of ensuring that it has a means of meeting demands on social safety net programs during a recession.

With regard to wartime, the proposed amendments are, if anything, too flexible, allowing room for increased spending. Balanced budget provisions are waived for any year in which a declaration of war is in effect, or when the United States is engaged in military conflict. Then, a simple majority of members in both chambers can waive the amendment.

Yet for the past 10 years we have been engaged in military conflicts in Afghanistan, Iraq, Libya, and Somalia. Hence, as worded, the current version of the amendment would have been already overridden. In my opinion, an exception should be made only for a declaration of war by the United States against another country. Even in this case, the exceptions should be limited to military spending, rather than to all spending. Otherwise, Congress has an excuse to restart the spending machine once again.

Another possible improvement would be to change the way spending programs are funded. Currently, programs are constructed so as to obligate the government to pay programs indefinitely. This leads to the current result that an increasingly larger share of the budget is obligated by prior Congresses, because few politicians have the courage to reduce benefits.

In contrast, if Congress could vote for a new program only as a percent of total spending, then the upward trend in program expenses would have to be approved as the program expanded. A housing program, for instance, could be set at 1.5 percent of spending. If revenues fell in a recession year, Congress would have to vote to maintain spending at the prior level.

Even better, Congress should get rid of the concept of entitlements, and put all expenses under the appropriations process. It is an abdication of responsibility to say that prior Congresses obligate the current Congress to spend money. Instead, Congress should pass a law that says that no money gets spent unless it gets specifically voted out each year. This could happen with a one-sentence law: "Notwithstanding any other provision of law, the United States shall expend no funds and shall be responsible for no liabilities and guarantees, except in amounts as specifically appropriated annually by Congress."

Congress should also consider putting the federal government on Generally Accepted Accounting Principles, like businesses. Congress has exempted itself from GAAP, and has adopted accounted conventions that only apply to the federal government. To most accountants, the federal budget is nonsensical.

If the federal government had to file its accounts under GAAP, our current measures of both deficit and public debt would be much greater. Today, no obligations are counted beyond 10 years. They just do not exist. We count our deficit and debt on a cash basis, with no accrual accounting. Therefore, obligations decades out do not show up. This should change.

America would benefit economically from regaining control over our spending. The American people share this view, because most members of Congress were elected on a platform of spending cuts—although not all had the same cuts in mind.

In the absence of fiscal discipline from our politicians, some form of balanced budget amendment would improve the budget process, put spending on a lower path, and increase GDP growth.

The U.S. budget faces deficits as far as the eye can see. It is a sad commentary on our budget process that these deficits, with open budgeting, would actually be even larger than they now appear. Perhaps restoring some sense to budget rules would rescue Congress from its low approval ratings and rehabilitate its reputation with the public.

Thank you for giving me the opportunity to testify today. I would be glad to answer any questions you might have.