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A LEGACY OF DEBT?

The Balanced Budget Amendment and the Next Generation

By Richard Kogan and [Robert Greenstein](#)

One of the main arguments used on behalf of the balanced budget amendment is that without it, we will bankrupt our children and grandchildren. Many of its proponents contend the balanced budget amendment is necessary to avert a catastrophe of this nature.

This argument makes an appealing sound-bite. It does not stand up well, however, under scrutiny.

- The Congressional Budget Office forecasts that very large deficits in coming decades could harm the economy, but that moderate deficits would not. An important CBO analysis issued in 1996 projects that if deficits through 2030 are held to about 1.5 percent of the Gross Domestic Product — about \$110 billion in 1996 terms — total income per person will *grow 41 percent* between now and 2030. In other words, with moderate deficits of this size, the U.S. economy will continue growing and living standards will rise appreciably. Furthermore, the same CBO analysis projects that if the budget is balanced every year through 2030, income per person will rise by 43 percent during this period, *virtually the same amount*.

In short, CBO finds that there would be *little difference in living standards over the next 35 years under a balanced budget requirement and under a policy of moderate deficits*. As a result of this finding, CBO has stated that "...sustainable policies do not require balanced budgets" if deficits are kept to moderate levels.¹ The CBO analysis punctures the contention that a constitutional balanced budget amendment is necessary to save us from an economic meltdown or a deterioration in the living standards of future generations.

- This raises a question: What is the evidence that policymakers will eliminate deficits or keep them to modest levels in the absence of a constitutional amendment? The answer is that the nation's track record in limiting deficits to modest levels is, overall, a good one. Over the past decade, Congress and administrations of both parties have succeeded in bringing down the high deficits of the early 1980s; the deficit has declined from 5.1 percent of the Gross Domestic Product in fiscal year 1986 to 1.4 percent in fiscal year 1996. The progress of the past decade demonstrates that Congress and administrations of both parties can achieve fiscal prudence without a constitutional requirement. Furthermore, a bipartisan agreement to balance the budget by 2002 is likely to be consummated in the months ahead.

Nor is the last decade atypical. For more than 200 years, the nation strove to keep deficits small or non-existent. Other than to finance wars or provide temporary relief from recessions, the only time the U.S. government adopted policies that sharply widened the deficit was during the early Reagan years, and those policies were adopted in the mistaken hope that the 1981 tax cuts would generate so much economic growth that deficits would not rise. When it became clear this experiment was not working, Congress and three administrations spent the rest of the 1980s and 1990s pushing the deficit genie back into the bottle. The deficit, measured as a percentage of GDP, has shrunk more than 70 percent over the past 10 years. Evidence is lacking that the nation needs a risky constitutional amendment to pursue responsible fiscal policies and avoid large, damaging deficits.

- A constitutional amendment also could adversely affect those who are now young by preventing the government from saving now to meet the high cost of future retirement and health benefits for the baby boom generation. Contrary to the claims that the amendment is needed to protect our children, the amendment could actually work against their interests because it would prohibit adoption of the very type of fiscal policies that would treat them most equitably in the decades ahead. Families typically save in some years and spend more than they earn in other years when their expenses are high in relation to their incomes, such as years in which a child is attending college or a breadwinner has retired. Families spread the temporary bulges in costs that occur during these periods over a larger number of years. The federal government could follow a similar course; rather than financing the large costs of the baby boom generation's retirement entirely out of government receipts collected during those years, it could spread the bulge in costs over a longer period. This could be done by running modest surpluses in years before the baby boomers retire and permitting modest deficits during their retirement.

That would be the most equitable approach for younger generations. If all of the Social Security, Medicare, and other government costs incurred during the baby boom generation's retirement must be covered by revenue collected in those same years, very large burdens will be imposed upon those whose peak earnings years fall between 2010 and 2040. Those working in those years will likely have to shoulder both large increases in taxes and sharp reductions in basic government services. Spreading the costs over a longer time-frame would be fairer to them.

But the constitutional amendment prohibits this more equitable approach because it requires all government expenditures to be financed from revenue collected the same year. The amendment thus could cause the fiscal burdens that today's

youth will shoulder in the next century to be considerably larger than need be the case.

The Gloom and Doom Forecasts of Amendment Advocates

Some advocates of the balanced budget amendment prophesy an economic apocalypse in the absence of the amendment. They argue that future generations will be saddled by massive debts. They speak of threatened national bankruptcy and economic ruin. The following statements by two Members of Congress are fairly typical.

Imagine a day 30 years in the future as your children are planning to retire. They have worked all their lives, spent frugally, and saved religiously. Yet the federal government has continued to run massive budget deficits, piling up an unconscionable amount of debt. One day your children wake up and find that the rest of the world no longer believes that the United States is able to meet its financial obligations. Thus, the value of the dollar crashes in financial markets. The Federal Reserve cannot stop the falling dollar. And in response the Treasury prints money. Suddenly — yes, suddenly — your children's assets are worth half of what they were a day before. Inflation is rampant and we are reduced to a Third World country.²

By any business standard the United States of America is probably bankrupt. We probably have promised away the American dream.³

The threats are so dire, these amendment advocates warn, that we need to amend the Constitution to prohibit any further government debt and require a balanced budget every year, except when supermajorities of both houses of Congress vote to waive such strictures. They argue for taking this step even though the constitutional amendment poses significant risks of making recessions more frequent and deeper and altering the balance of powers among the three branches of government.⁴

But the premises of disaster are seriously overstated. A constitutional requirement mandating a balanced budget each year goes far beyond what is needed to prevent dire outcomes and leave future generations noticeably wealthier than current generations.

National Wealth Has Grown in Recent Years Despite Deficits

The [graph](#)* depicts changes in the net wealth of the country since 1959. It demonstrates that the wealth of the United States has grown during periods of relatively low deficits, such as the 1960s and 1970s, and also during the higher-deficit years of the 1980s. These deficits did not cause national wealth to stop growing or make future generations poorer, although the large deficits of the 1980s appear to have contributed to a slowing of the growth in national wealth during that period.⁵ (In the [graph](#)*, the solid line measures the trend — or average growth rate — of wealth from the peak of one business cycle to the next. Wealth

tends to shrink during recessions, largely because the value of assets declines, and then to bounce back. The dotted line shows the actual net wealth level for each year.)

The slower growth in wealth during the 1980s occurred during a period when the deficit reached levels sufficiently high that the federal debt climbed as a percentage of the Gross Domestic Product. When the ratio of the federal debt to the Gross Domestic Product increases, the interest payments the government must make on the national debt begin to grow at a substantial clip.

Today, the federal debt stands at \$3.8 trillion. This equals 50 percent of the Gross Domestic Product and 15 percent of national wealth. How serious a problem does this pose? A household analogy may help. The current situation is somewhat analogous to that of a household with annual income of \$60,000 that has debts, such as a mortgage, totaling \$30,000 and savings and investments worth \$230,000. Such a household would be considered to be in solid financial shape, and its debts would not be considered excessive. Similarly, the current federal debt, while substantial, does not pose economic dangers.

But federal debt can grow to levels at which it would pose serious dangers. The Congressional Budget Office has analyzed scenarios in which the debt reaches sufficiently high levels that the compounding of interest on the debt causes the debt to grow faster than the economy (as happened in the 1980s). If such a development were to recur and to persist over a long period of time, it would eventually lead to what CBO terms a "debt explosion." At that point, debt would begin to grow explosively and threaten the functioning of the economy. CBO has calculated that if the nation were to institute no deficit reduction measures and to pay for all of the retirement costs of the baby boom generation by borrowing, thereby allowing the deficit to balloon to record levels for peacetime and to remain at such levels, the federal debt would eventually grow so large that a debt explosion would occur about 30 to 40 years from now.⁶

That the nation must not allow a debt explosion to occur is clear; the CBO analysis is persuasive on this point. But the CBO analysis shows that a constitutional amendment requiring the budget to be balanced each year is not necessary to avoid the calamity of a debt explosion.

Moderate Deficits Versus a Balanced Budget

In assessing strategies to avoid a debt explosion, CBO simulated the effects of two alternative, long-term budget policies. Under one approach, the budget would be balanced in 2002 and every year thereafter. Under the alternative, the budget would not be balanced, but deficits would be restrained to a sufficient degree that the debt grew no faster than the economy and the debt-to-GDP ratio remained at its current level. The alternative strategy would entail annual budget deficits averaging about 1.5 percent of GDP; that would be lower than any deficit during the 1980s or early 1990s, but slightly higher than the deficit in 1996, which was 1.4 percent of GDP. In 1996, a deficit equal to 1.5 percent of GDP would have been about \$110 billion; the actual deficit last

year was \$107 billion.

CBO's two alternate strategies allow comparison of the effects of 30 years of balanced budgets to 30 years of "moderate" deficits under which the debt-to-GDP ratio remains constant. CBO's findings are instructive.

- CBO estimated that under the balanced budget scenario, the gross national product would rise 43 percent on a real per capita basis between 1995 and 2030, increasing from \$24,800 for each man, woman, and child in 1995 to \$35,500 in 2030, after adjusting for inflation. By 2030, future generations would, on average, be 43 percent more prosperous than current generations are today.
- Under the moderate deficit scenario, *the results are almost identical*. CBO estimated that under this approach, real per capita GNP would rise 41 percent — from \$24,800 to \$34,900. CBO concluded that "The economic benefits of stabilizing the debt-to-[GNP] ratio are almost as large as those of balancing the budget."⁷

The CBO analysis indicates that under a moderate deficit path, national income and wealth would continue to grow, and coming generations would inherit a sound economy and growing economic assets. The effects on growth would be little different under modest deficits than under a policy of absolute budget balance. This is not to say that the nation should adopt a policy of aiming for moderate deficits rather than, say, for moderate surpluses in some years and modest deficits in others. But it underscores the point that placing restrictions regarding the budget and the debt limit in the Constitution, with all of the risks that such action entails, is not necessary to safeguard the economy and leave future generations better off than current generations.

This leaves one question: To ward off a debt explosion, might we need a constitutional prohibition on large deficits? Our nation's history strongly suggests this is not the case. For more than 200 years, our political system has been successful in holding any deficits that occurred to modest levels.⁸ Other than to finance wars or provide relief from recessions, only once in our history did the government adopt policies that directly increased the deficit — during the early years of the Reagan Administration. Even on that occasion, these policies were adopted in the mistaken hope that the large 1981 tax cuts would generate such robust economic growth that they would not cause deficits to rise. When it became clear the experiment was not going to work, Congress spent the rest of the 1980s and the 1990s squeezing deficits back down. The efforts of Congress and three Administrations met with significant success in this regard — between 1986 and 1996, the deficit shrank from 5.1 percent of GDP to 1.4 percent.

In short, evidence that the nation needs a constitutional amendment to keep deficits from spinning out of control is lacking. Indeed, to aver that the constitutional amendment is necessary to prevent catastrophe and the impoverishment of future generations, one must argue that future Congresses and administrations will be so short-sighted and irresponsible that they will stubbornly refuse to take deficit reduction measures in the face of the baby boomers' retirement and will continue to balk at such action even when the deficit reaches and surpasses its highest levels of the 1980s and we begin sliding toward a debt explosion.

Our nation's history, including its recent history, provides strong evidence we will not allow that to transpire.

The Amendment Can Result in Inequitable Treatment of Future Generations

Finally, the constitutional amendment could injure those who are young today by prohibiting the adoption of the type of fiscal policies that would treat them most equitably. When families face large future costs, such as for sending children to college, they often build up savings in advance that they tap when their children's college years arrive. Similarly, many individuals save and build up assets during their working years that they draw down in their retirement years. The point is that families typically do not pay for all of college or retirement costs out of their current incomes; they spend less than they earn in some years in order to save, while spending more than they earn in other years when their needs require that. Most states follow a similar course, saving funds during flush times and placing them in "rainy day funds," then drawing the funds down when need increases and state expenditures exceed state revenues.

The balanced budget amendment, however, would prohibit the federal government from following such an approach. All government expenditures for a given year would have to be paid for with revenue raised that same year. The government could not build up surpluses in favorable years and draw them down to help balance the budget when need increased.

Thus, the constitutional amendment would preclude the federal government from building up savings over the next 15 years while most of the baby boomers will still be working to help meet costs that will mount after they retire. All federal expenditures for any given year, including the cost of Social Security and Medicare benefits provided that year, would have to be financed in full by revenue collected in that year.

The result would be unfavorable to those who are young today. For all expenditures, including Social Security and Medicare, to be financed from current revenue during the years the baby boom generation is retired, one of the following will have to occur: a) taxes will have to be raised to high enough levels in the years the baby boom generation is retired to cover all Social Security, Medicare, and Medicaid costs in those years plus all other government costs; b) the rest of the budget will have to be cut to such an extent that the federal government will have difficulty performing some of its basic functions other than providing for the elderly; or c) Social Security and Medicare benefits will have to be reduced very sharply. The degree to which Social Security and Medicare benefits are reduced is likely to be circumscribed by what the public, with its increasing contingent of elderly citizens during the baby boom's retirement years, will tolerate. The conclusion to which this leads is that under the balanced budget amendment, the tax increases and cuts in public services that those who are young today will have to shoulder in those years could prove to be very large.

That need not be the case. The baby boomers' retirement will leave the nation with a temporary bulge in costs. Just as families

spread temporary bulges in costs for college or retirement over many years, so could the federal government. A more equitable policy than financing all of the baby boom generation's retirement costs out of current income — and thereby imposing a special burden on workers whose peak earning years will occur between about 2010 and 2040 — would be to spread the temporary bulge of costs across a longer time period. This could be done by running modest surpluses in years before the baby boomers retire and permitting deficits during their retirement years.

By requiring all government expenditures to be financed from the same year's income, however, the balanced budget amendment would preclude such a policy. It consequently may cause the fiscal burdens that today's youth will have to bear in the next century to be larger than need be the case.

Footnotes

¹ Statement of James L. Blum, Deputy Director of Congressional Budget Office, on "The Long-Term Budget Outlook and Options," before the Senate Budget Committee, January 22, 1997, pp. 16-17.

² Sen. Richard Shelby, June 5, 1996, *Congressional Record*, page S5841.

³ Rep. Sam Horn, December 21, 1995, *Congressional Record* page H15561.

⁴ For a discussion of how the amendment would likely exacerbate economic downturns, making recessions deeper and more frequent, see "[The Balanced Budget Constitutional Amendment](#)," Center on Budget and Policy Priorities, December 1996. For a discussion of the amendment's potential effects on the balance of powers, see Richard Kogan, "[Enforcement of a Constitutional Balanced Budget: Questions Without Answers](#)," Center on Budget and Policy Priorities, January 6, 1997.

⁵ Most economists concur that the large drop in net national saving that occurred in the 1980s was a major factor behind the slowdown in the growth of wealth during that period. The large deficits of those years were one of the principal reasons for the large drop in net national savings.

⁶ See Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1997-2006*, May 1996, Chapter 4.

⁷ *Ibid.*

⁸ Until the early 1980s, any deficits in periods other than wars or recessions were sufficiently small that the national debt *declined* as a percentage of the Gross Domestic Product. For example, the nation ran small or modest deficits during most years of the 1960s and 1970s, and between 1960 and 1980, the debt declined as a percentage of GDP.

* Please send your fax number via e-mail to bazie@center.cbpp.org to receive the graph indicated above.

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