

The Compact for Balanced Budget: *Section by Section BBA Analysis*

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Overview

Looking to Washington is not the solution to our fiscal crisis. There is a reason for that – it is the unchecked concentrated power to incur limitless debt in Washington that is the problem. Think about it: Washington is an outrageously bankrupt debtor and what does the Constitution allow for? It allows for that same debtor to write its own credit limit. This is a dangerous concentration of power. The exponential growth of spending that is happening in Washington should not be any surprise—how could it be any other way?

The national debt problem is a systemic problem. It is a systemic problem because debt enables unprincipled elected officials in Washington to essentially buy votes. They can buy all the political benefits of the spending (or unsustainable tax policies) that they want and then shift the costs to non-voting future generations with little or no immediate impact on their political careers. That is why 49 states currently have some form of debt limit or balanced budget requirement either in their constitutions, or by case law or statute. The states recognized long ago that the potential for abuse of unlimited borrowing capacity is too great to tolerate in a republican form of government that must protect future generations as much as the present.

Over 200 years ago, in 1798, Thomas Jefferson said that if there was just one more amendment that would take away the power of borrowing from the federal government then that would be enough to restore the Constitution to its original principles. What was true fewer than 10 years after ratification is still true today. This is exactly what is at the heart of the Compact for a Balanced Budget. It is a powerful and plausible balanced budget amendment, every policy component of which polls out with supermajority support. It is not meant to be an exercise in abstract reasoning. Time is of the essence—the future of our children is in jeopardy.

The following overview specifies the text and describes the goals and objectives of the seven sections of this powerful amendment, which is at the heart of the Compact for a Balanced Budget:

Section 1

“Section 1. Total outlays of the government of the United States shall not exceed total receipts of the government of the United States at any point in time unless the excess of outlays over receipts is financed exclusively by debt issued in strict conformity with this article.”

Summary: Section 1 is the definition of balance. This section says that total outlays, meaning total expenditures, are limited at all points in time to total receipts, which are defined as all tax receipts and other income but excluding the proceeds from debt or the incurrence of a liability. The intention of this definition is to limit spending to only taxes and cash inflows like taxes. The only exception to this rule is the use of the line of credit described in Section 2 to handle cash flow volatility.

Commentary: Is it possible to have a “non-gameable” definition of balance that will survive attempts by Congress to undermine the amendment? Yes, in fact it is very simple – you restrict spending to cash flow at any and every point in

time. Obviously, there is cash flow volatility on a daily basis – taxes don't always come in when spending needs to occur, or tax revenues may not be enough to cover appropriated expenditures. How is this handled? Again – very simple - you provide an approved revolving line of credit that that can be tapped to handle the cash flow volatility.

Section 2

“Section 2. Outstanding debt shall not exceed authorized debt, which initially shall be an amount equal to 105 percent of the outstanding debt on the effective date of this article. Authorized debt shall not be increased above its aforesaid initial amount unless such increase is first approved by the legislatures of the several states as provided in Section 3.”

Summary: Section 2 is the establishment of the revolving line of credit. It is initially fixed at 105% of the total outstanding debt on the date of ratification.

Commentary: As an example, if there were \$20 trillion of outstanding debt at the time of ratification, the revolving line of credit would be initially set at \$21 trillion. The extra \$1 trillion would provide approximately 1 to 1.5 years of borrowing capacity based on the current annual deficit rates. This is the time period that Congress will have to try and figure out what to do next.

Section 3

“Section 3. From time to time, Congress may increase authorized debt to an amount in excess of its initial amount set by Section 2 only if it first publicly refers to the legislatures of the several states an unconditional, single subject measure proposing the amount of such increase, in such form as provided by law, and the measure is thereafter publicly and unconditionally approved by a simple majority of the legislatures of the several states, in such form as provided respectively by state law; provided that no inducement requiring an expenditure or tax levy shall be demanded, offered or accepted as a quid pro quo for such approval. If such approval is not obtained within sixty (60) calendar days after referral then the measure shall be deemed disapproved and the authorized debt shall thereby remain unchanged.”

Summary: Section 3 is the referendum process whereby if Congress wants to increase that initial revolving line of credit, it would refer out a measure to the states and a majority would have to approve the debt limit increase. The significant thing about this provision is that it deems void (in combination with Section 4, discussed below) any issuance of debt that is premised on a quid-pro-quo for such approval. This means the possibility of the states being coerced or literally bribed into approving a debt limit increase is greatly minimized because it risks the soundness of the bond issuance. The issuance could be deemed void as a result of such horse-trading, which could spook the bond markets. This would keep the referendum process clean and non-coercive, more like what is seen in bond referendums at the school district level.

Commentary: The key thing to understand about this amendment is that the initial debt limit is fixed constitutionally. Unlike the current system, the debtor (the federal government) does not get to set its own credit limit. The federal government would not have any power independently or exclusively to raise its own debt limit as it has, or to eliminate it. Instead, any proposal to increase the debt limit requires a referendum of the state legislatures. In other words, a simple majority of the state legislatures have to approve a request by Congress. Keep in mind that this is the kind of system we typically entrust our school boards with. We do not trust our school boards in issuing new bonds without a referendum and yet we have the federal government doing this on a daily basis. With this oversight function, the states will begin to restore their proper role within the Constitution's balance of federalism.

Section 4

“Section 4. Whenever the outstanding debt exceeds 98 percent of the debt limit set by Section 2, the President shall enforce said limit by publicly designating specific expenditures for impoundment in an amount sufficient to ensure outstanding debt shall not exceed the authorized debt. Said impoundment shall become effective thirty (30) days thereafter, unless Congress first designates an alternate impoundment of the same or greater amount by concurrent

resolution, which shall become immediately effective. The failure of the President to designate or enforce the required impoundment is an impeachable misdemeanor. Any purported issuance or incurrence of any debt in excess of the debt limit set by Section 2 is void.”

Summary: Section 4 regulates the impoundment process that is necessary to enforce the amendment’s debt limit. Roughly six months prior to hitting the debt limit, all the parties will be required to put their cards on the table as to what they would have to impound if the debt limit is not increased or if taxes or spending are not raised or cut.

Commentary: The section deals directly with the concern about the “game of chicken” that is currently being played with the debt limit. The debate starts at the last moment and goes into the midnight hour; the credit rating of the country is threatened; and in the end, everything is ignored anyway because Congress ultimately raises the debt limit.

Built into this amendment is a very simple process to avoid these problems. As soon as the nation’s borrowing is within two percent of the debt limit (another way to say this is that 98% of the current debt limit has been reached) the President would have a mandatory obligation to start delaying spending in anticipation of reaching the debt limit. This is called an “impoundment.” And this is not a new power. It is actually an implied power that Presidents have always had, the only proviso being that the Supreme Court has ruled that impoundments cannot be used for political retaliation or disregarding congressional appropriations were sufficient funds exist to implement them. This is still the case law today. It would still be the case law if this amendment were in place.

Using the example where the debt limit is initially established at \$21 trillion, the impoundment threshold would begin when outstanding debt reached 98% of this amount, or approximately \$20.6 trillion. The 2% cushion would provide approximately six months of lead time before the debt limit would be reached at current deficit spending rates. At that point, the President would have to take the politically-risky move of designating what would have to be delayed in order to enforce the debt limit. Congress would have 30 days to override the President’s proposed impoundments with alternatives of equal or greater amounts. With this amount of lead time – there will be no game of chicken. What it will do is force everyone’s cards on the table and start a serious discussion that is transparent to the American People.

We will know who is responsible for any impoundment that is enforced. There will not be hands pointing to each other. It will either be the President’s impoundments or it will be Congressional impoundments. And if neither one acts, spending will be limited to tax receipts as soon once the debt limit is reached. At that time, there will be an automatic sequester that limits spending to tax receipts per the language of section 1. The amendment further provides that the President could be impeached for allowing this to occur.

Section 5

“Section 5. No bill that provides for a new or increased general revenue tax shall become law unless approved by a two-thirds roll call vote of the whole number of each House of Congress. However, this requirement shall not apply to any bill that provides for a new end user sales tax which would completely replace every existing income tax levied by the government of the United States; or for the reduction or elimination of an exemption, deduction, or credit allowed under an existing general revenue tax.”

Summary: Section 5 furnishes a constitutional tax limit. It establishes the general rule of two-thirds vote of each house of Congress is required for any increased or new taxes, with three exceptions of using simple majority votes to 1) move to a fairer tax by replacing the current income tax system with a national sales tax, 2) move to a flatter tax code by eliminating loopholes, exemptions, credits and deductions, or 3) to increase tariffs and fees. This approach is considered a compromise that is principled in nature.

Commentary: We have a moral choice here. Let’s not forget that if we intend to repay our debt – then that repayment is made through taxes. So debt is taxes if we intend to repay it. The idea that somehow restraining debt is not limiting taxes is not true - restraining debt is limiting taxes. If we don’t limit debt, what we are really doing is we are saying we want to tax future voiceless non-voting generations for our policy choices today. In other words, if we don’t limit debt,

we would rather have taxation without representation – a violation of a basic principle our country was founded upon. Basically you are denying the voice of people impacted by this country’s decisions in the political process through unlimited debt.

Nevertheless, this section avoids the possibility of a “tax-mageddon.” Some are concerned that if debt is restrained too much, dangerous tax increases will occur in the short term. No doubt, there could be some really bad tax policy if we swing too far in the way of increasing revenues. Consequently, the amendment requires that 2/3 of the whole of each house (not a quorum) would have to approve any new tax or any increase in an existing tax - but with three key exceptions. There is an exception for completely replacing the current income tax with an end-user sales tax. This exception is, in fact, a limitation on the federal government’s existing taxing authority. Right now, without the amendment, Congress could levy a national sales tax as a type of excise or impost with only simple majorities in both houses. Indeed, without this amendment in place, Congress could levy a new national sales tax on top of the current income tax. The balance budget amendment would prevent this – providing an improvement and a restriction on Congressional taxing power that does not currently exist. This is because the amendment would require any new national sales tax to completely replace all existing income taxes if it were to be approved with simple majorities of Congress. This would be a one-time occurrence because once all existing income taxes are replaced by a new national sales tax, the provision cannot be invoked again.

Another alternative for raising revenue would be to eliminate deductions, credits and exemptions – typically called “loopholes.” That can be done with simple majorities. Estimates range up to a trillion dollars in revenue that could be obtained by flattening out the tax code that way. And finally, tariffs or fees are not touched by this amendment. They could continue to be enacted or raised by simple majority votes of Congress as is the currently the case.

Some may say this is not enough protection from taxes. That criticism must be thought through carefully in terms of the political dynamics of the amendment. If Congress wants to exercise simple majority approval of any increase in revenue, they will be forced to run through a narrow gap. They will be forced to run head-long into powerful special interests. This would not preclude new tax revenues, but it will tend to cause deficits to be closed more by spending cuts first. Thus, while the amendment provides flexibility and an opportunity for increased tax revenues, it minimizes the risk of tax-mageddon. At the same time, it also recognizes the moral fact that it is wrong to tax future generations for the policy choices of today in the name of maintaining unlimited borrowing capacity.

Section 6

“Section 6. For purposes of this article, “debt” means any obligation backed by the full faith and credit of the government of the United States; “outstanding debt” means all debt held in any account and by any entity at a given point in time; “authorized debt” means the maximum total amount of debt that may be lawfully issued and outstanding at any single point in time under this article; “total outlays of the government of the United States” means all expenditures of the government of the United States from any source; “total receipts of the government of the United States” means all tax receipts and other income of the government of the United States, excluding proceeds from its issuance or incurrence of debt or any type of liability; “impoundment” means a proposal not to spend all or part of a sum of money appropriated by Congress; and “general revenue tax” means any income tax, sales tax, or value-added tax levied by the government of the United States excluding imposts and duties.”

Summary: Section 6 includes the definition for terms used throughout the amendment.

Commentary: The definitions used in Section 6 are designed to maximize transparency and eliminate all known tactics used to circumvent constitutional debt limits. The definition of debt is meant to limit available credit to ordinary full faith and credit bonding. The definition of outstanding debt is meant to ensure that the debt limit is set in relation to bonds held anywhere and by anything—rather than off-books borrowing and other exotic means of funding government. This ensures, among other things, that debt held by the Federal Reserve is still counted against the debt limit even if the Federal Reserve (like the Bank of England recently declared) decided essentially never to cash them in. The definition of “total outlays” is meant to be as broad as possible to ensure the spending limit in Section 1 reaches all spending

attributable to the federal government. The definition of “total receipts” is designed to be as narrow as possible to prevent the deposit of receipts from trust fund-raiding, money printing, or sale/lease-back schemes from directly increasing the spending limit. The definition of “impoundment” is used to conform to the current constitutional understanding of the President’s inherent impoundment power to avoid any possibility that Section 4 could be construed as granting new impoundment powers, rather than regulating existing impoundment powers. The definition of “general revenue tax” is meant to restrict the two-thirds approval requirement of the tax limit to the subset of the federal government’s taxing powers that are most likely to be abused (income and sales taxes).

Section 7

“Section 7. This article is immediately operative upon ratification, self-enforcing, and Congress may enact conforming legislation to facilitate enforcement.”

Summary: Section 7 is the “self-enforcement” provision, which means that Congress does not have to pass any further laws or legislation to make the amendment effective. As soon as it is ratified, the amendment’s provisions take effect.

Conclusion

The balanced budget amendment offered by Compact for a Balanced Budget is incredibly powerful, yet plausible. Supermajority support exists for each of these components. With clear lines of accountability and powerful structural incentives, this amendment would finally force Washington’s political players to show their cards before hitting a hard debt limit, protecting our country’s credit from being held hostage. The prospect of real debt scarcity would force the political class to finally make the tough calls needed to save our future - and the futures of our children and grandchildren.

Now what do you think the chances are that Congress would ever propose an amendment like this without leadership from the states? We believe the answer is zero. That’s why the Compact for a Balanced Budget deserves your support.

THE BALANCED BUDGET AMENDMENT

Section 1. Total outlays of the government of the United States shall not exceed total receipts of the government of the United States at any point in time unless the excess of outlays over receipts is financed exclusively by debt issued in strict conformity with this article.

Section 2. Outstanding debt shall not exceed authorized debt, which initially shall be an amount equal to 105 percent of the outstanding debt on the effective date of this article. Authorized debt shall not be increased above its aforesaid initial amount unless such increase is first approved by the legislatures of the several states as provided in Section 3.

Section 3. From time to time, Congress may increase authorized debt to an amount in excess of its initial amount set by Section 2 only if it first publicly refers to the legislatures of the several states an unconditional, single subject measure proposing the amount of such increase, in such form as provided by law, and the measure is thereafter publicly and unconditionally approved by a simple majority of the legislatures of the several states, in such form as provided respectively by state law; provided that no inducement requiring an expenditure or tax levy shall be demanded, offered or accepted as a quid pro quo for such approval. If such approval is not obtained within sixty (60) calendar days after referral then the measure shall be deemed disapproved and the authorized debt shall thereby remain unchanged.

Section 4. Whenever the outstanding debt exceeds 98 percent of the debt limit set by Section 2, the President shall enforce said limit by publicly designating specific expenditures for impoundment in an amount sufficient to ensure outstanding debt shall not exceed the authorized debt. Said impoundment shall become effective thirty (30) days thereafter, unless Congress first designates an alternate impoundment of the same or greater amount by concurrent resolution, which shall become immediately effective. The failure of the President to designate or enforce the required impoundment is an impeachable misdemeanor. Any purported issuance or incurrence of any debt in excess of the debt limit set by Section 2 is void.

Section 5. No bill that provides for a new or increased general revenue tax shall become law unless approved by a two-thirds roll call vote of the whole number of each House of Congress. However, this requirement shall not apply to any bill that provides for a new end user sales tax which would completely replace every existing income tax levied by the government of the United States; or for the reduction or elimination of an exemption, deduction, or credit allowed under an existing general revenue tax.

Section 6. For purposes of this article, “debt” means any obligation backed by the full faith and credit of the government of the United States; “outstanding debt” means all debt held in any account and by any entity at a given point in time; “authorized debt” means the maximum total amount of debt that may be lawfully issued and outstanding at any single point in time under this article; “total outlays of the government of the United States” means all expenditures of the government of the United States from any source; “total receipts of the government of the United States” means all tax receipts and other income of the government of the United States, excluding proceeds from its issuance or incurrence of debt or any type of liability; “impoundment” means a proposal not to spend all or part of a sum of money appropriated by Congress; and “general revenue tax” means any income tax, sales tax, or value-added tax levied by the government of the United States excluding imposts and duties.

Section 7. This article is immediately operative upon ratification, self-enforcing, and Congress may enact conforming legislation to facilitate enforcement.