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Colorado's Balanced Budget Solution

By Barry W. Poulson

Economic stability requires a commitment to both price stability and a balanced budget. During the "Great Moderation" in macroeconomic policy in the 1980s and 1990s, it appeared that we had solved this commitment problem in the United States. Fed Chairmen Paul Volcker and Alan Greenspan committed to tighter monetary policies required to reduce inflation from the double-digit rates of the 1970s to lower target rates of inflation. They also made it clear that the success of these monetary policies depended on Congress balancing the budget and testified in support of new statutory fiscal rules mandating balanced budgets. In the late 1990s, Congress did balance the budget and price stability was restored.

Unfortunately, over the past two decades, this dual commitment to balanced budgets and price stability has been abandoned. Fed chairmen, including Jerome Powell, have failed to constrain the growth in the money supply as monetary policy in recent years has been a major source of instability in financial markets. The statutory fiscal rules put into place to balance the budget during the Great Moderation have been suspended and abandoned. The outcome of this lack of commitment has been stagflation, not unlike that of the 1970s.

The failure to solve the commitment problem is not surprising. Congress may commit to a balanced budget, as they did during the Great Moderation, but they can't commit a future Congress to pursue these policies. When the fiscal rules mandating a balanced budget are statutory, it is easy for federal lawmakers to circumvent or abandon fiscal rules, which they have done for several decades.

Experience at both the national and state level suggests an alternative route to solving the commitment problem. When fiscal rules are incorporated in the Constitution, it is more difficult for elected officials to circumvent or abandon them. Switzerland, for example, enacted a "debt brake" as a constitutional provision through referendum, with support from 85 percent of citizens. The Swiss debt brake mandates a balanced budget in the near term. The debt brake has enabled that country to significantly reduce debt as a share of national income for several decades. Different versions of The Swiss debt brake have been incorporated as constitutional provisions in other European countries as well as the European Union.

Our experience in Colorado set a precedent for solving the commitment problem at the national level. In 1978, the Colorado Legislature enacted a statutory Tax and Expenditure Limit (TEL). For several years, the statutory TEL did in fact constrain the growth in state spending. Eventually, taxpayers received tax rebates from surplus revenue. But, as in many states with statutory TELs, Colorado legislators watered down the TEL to the point where it was no longer an effective constraint on state spending. By the mid-1980s, with the collapse in oil prices, the Colorado economy was stagnating, and state spending outstripped the growth in state income.

But Colorado citizens solved the commitment problem through a citizen initiative that incorporated the Taxpayer Bill of Rights (TABOR) in the Colorado Constitution. For three decades, the TABOR amendment has constrained the growth in state revenue and spending while enabling the Legislature to balance the budget. If any unit of government in Colorado wants to increase taxes or issue new debt, it must have voter approval. Colorado citizens continue to receive tax rebates from surplus revenue above the TABOR limit. Despite efforts to water down or abandon TABOR, it remains the gold standard for state fiscal rules. The experience with TABOR in Colorado demonstrates how citizens can use constitutional fiscal rules to solve the commitment problem. Since TABOR was enacted, Colorado has created one of the best business tax climates and experienced one of the highest rates of economic growth in the country. TABOR turned Colorado into a little Switzerland.

Could constitutional fiscal rules solve the commitment problem at the national level, given the absence of initiative and referendum? Citizens have the power to propose amendments under Article V of the U.S. Constitution, and significant progress has been made in recent years toward incorporating a fiscal responsibility amendment in the Constitution. By 1979, two thirds of the states had submitted resolutions to Congress calling for an amendment convention under Article V.; but Congress failed to even count these resolutions. This year, Rep. Jodey Arrington (R-TX) and cosigners introduced HCR 24, which would establish a path for the states to propose a fiscal responsibility amendment to the U.S. Constitution. The Federal Fiscal Sustainability Foundation has asked state attorneys general to consider a mandamus case to force Congress to fulfill its constitutional duty as described in HCR 24.

Calling an Article V convention to incorporate a fiscal responsibility amendment in the Constitution may be the only way that citizens can restore sustainable fiscal polies. Passage of such an amendment would allow citizens, rather than special interest groups and elected officials, to decide how much government they want and are willing to pay for. Restoration of a balanced budget would not occur overnight, but such an amendment could set the country on a path toward fiscal sustainability. Of course, this must be accompanied by a commitment by the Fed to restore price stability. If the Fed fails to make this commitment, citizens may need to incorporate monetary rules as well as fiscal rules in the Constitution.

Colorado has become a little Switzerland, demonstrating how to solve the commitment problem using constitutional fiscal rules. At the national level, elected officials are behind the learning curve. It is time for citizens and their state representatives to take the bull by the horns and call for an Article V amendment convention. New constitutional fiscal and monetary rules could mandate that the federal government fulfill the dual commitment to balanced budgets and price stability.

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