

THE PROGRESS REPORT

How to Really Balance the Budget

By Fred E. Foldvary

The recent defeat of the Balanced Budget Amendment provides an opportunity to go back to the drawing board and craft a Constitutional amendment more consistent with sound economic policy.

First, separate the federal budget into capital and operating sections. The capital budget would finance the construction of public works, such as highways, space stations, and major pollution clean-up projects. These can be funded partly from debt for the same reason that households borrow to buy a house or a car, or local governments go into debt to build a subway. If these are productive investments, they will provide a dividend in the future in greater productivity or well-being, so it can be sound to spread the costs out into the future.

However, just as mortgages have finite lengths and are eventually paid off, unless refinanced, debt for capital projects should be in the form of bonds for specific projects, with a maturity date when the bonds are fully paid off. The capital budget would therefore consist of current revenues plus bonds earmarked for specific projects and for a specific length of time such as 30 years during which the principal and interest of the bonds are amortized.

The operating budget should be for current consumption or operations, and would need to be strictly balanced each year.

One argument against a balanced budget is the fact that expenses and revenues will vary as the economy expands and contracts. If the economy is officially in a recession, the treasury could issue "recession bonds" specific for that year, with a payoff of ten years. Otherwise, if the operating budget has a deficit, an across-the-board cut is made to all sections of the budget. If Congress wishes to avoid the cut, it must then vote to obtain more revenue by any means except borrowing.

Several decades ago, the Swedish economist Knut Wicksell established the fiscal principle that each item of expenditure must be linked to some means of financing. By limiting the duration and purpose for debt, the budget will follow Wicksell's sound proposal.

Wicksell also recognized that rent is the best source of government revenue. When land rent is the only tax, then government debt is a claim on future rents. If the debt is for consumption rather than for investment, it capitalizes land value down just as the collection of rent does. Too much debt for consumption can even make land value go negative, since the debt and rent collection reduce the benefit of land without a corresponding benefit from current or future services. Landowners would organize to oppose debt used for current operations. So besides a Constitutional amendment, another way to limit government debt would be to base taxation on land rent.

