

INVOKING ARTICLE 292 TO CONTAIN
CENTRE'S DEFICITS: THE PITFALLS

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Invoking Article 292 to Contain Centre's Deficits : The Pitfalls

Persistent deficits in the Government's budget and the resulting growth of public debt have led to suggestions for measures like imposition of a constitutional limit on the Centre's borrowings and invoking Article 292. The suggestion derives inspiration from the Balanced Budget and Emergency Deficit Control Act - better known as the Gramm-Rudman-Hollings Act - which was adopted by the US Congress in 1985. That Act required a steady decline in the Federal government's budget deficits so that the deficits were reduced to zero in 1991. Failure to adhere to the limits laid down would force spending cuts and/revenue increases and failing that, automatic, across-the-board cuts in expenditures. Some other countries too have attempted to force the government to observe fiscal prudence by laying down a "balanced-budget rule" (e.g., Indonesia) but few have gone so far as the USA to have a legislative ceiling on the budget deficit. Although, according to advocates of balanced budget, the Gramm-Rudman Law has had some restraining influence on the growth of Federal government's spending, US experience amply shows that implementation of a legislative ceiling on government's budget deficits is far from simple and is not a real remedy for the phenomenon of deficits. Many influential economists have also been of the view that any rigid rule limiting the government's ability to use the fiscal instruments

for managing the economy is harmful and undesirable. This note examines the pros and cons of such a move in India in the light of US experience.

US Experience with Gramm-Rudman Act

Contrary to what many would have thought, the operation of Gramm-Rudman Act encountered problems right from the beginning. First of all, it could not touch some of the fast growing expenditure items.

Even when the Act was on the anvil, it was envisaged that certain expenditure programmes of the federal government could not be subjected to cuts. Thus most social welfare programmes were exempted wholly or partly from the cuts. Though not liked by President Reagan, half of all cuts came from defence spending and other domestic accounts. Despite all that the deficits could not be contained within the limits set. What is more, there was a constant wrangle between the Congress and the Treasury about the actual quantum of the limits beyond which automatic cuts would come into operation.

To avoid the hassles, and any constitutional challenge to the automatic cuts, it was decided that the Congress Budget Office (CBO) and the President's Office of Management and Budget (OMB) would prepare a joint report estimating the deficit for a coming fiscal year and calculate the size of the deficits needed to reach the deficit target. If the estimates of the two agencies differed, their results would be averaged and the differences split. The CBO-OMB report would then be reviewed by the General Accounting Office (GAO) which would make changes where it disagreed and issue a second report. The President would be required to sign the GAO report as an executive order promulgating the automatic cuts.

Even with all this, there were problems in operating the limit. As anticipated, the Act was taken to the court. In February 1986, a special three-judge panel of the federal district court in Washington D.C. held that the GAO's role in ratifying the amount and scope of automatic, across-the-board cuts - which were obligatory for the President to follow - was constitutionally impermissible under the doctrine of separation of powers. This verdict was subsequently upheld by the US Supreme Court. The reasoning underlying the Court's pronouncement was based on a simple concept of constitutional law, viz., that one branch of government should be able to act independent of the other two, except to the degree that the Constitution provided for direct "checks and balances". The courts took the view that the GAO was essentially a legislative branch particularly since the Congress, and not the President could remove the Comptroller General from Office (Two justices of the Supreme Court dissented from the majority view).

Even otherwise, in the first year of the Act, neither the Congress nor the President followed the letter of the Law. The court verdicts seemed to put a final seal on it. However, in 1987, attempts were made to revive the Gramm-Rudman's procedure for automatic cuts although the law's deficit targets were pushed back. The stock-market crash of 1987 induced the President and the Congress to negotiate "face to face" on the deficit. The budget summit helped reach an accord on two-year spending ceilings for defence, foreign aid and discretionary domestic programmes. Also, the President agreed to a tax increase.

In 1987 the Congress restored the cuts but through a change in the procedure. The role of GAO in making deficit projections was eliminated. Estimates could still be prepared by CBO but the OMB would have the final say. However, the Congress laid down

some strict limits on the way OMB could calculate the economic and technical parameters that lead to deficit projections. This was intended to guard against political manipulation of the numbers and also to prevent gimmicks like sale of government assets which had been resorted to by the government to reduce deficit. The deadline for zero deficit budget was pushed forward to 1993. In 1988, the Congress was left to face a deficit target of \$110 billion (against an original target of \$72 billion). But, as a survey of Gramm-Rudman's operation puts it, "the deficit was on anything but a downward path that would lead to that target".¹

Lessons of Gramm-Rudman for India

The US experience clearly brings out that, however desirable it might appear, enforcing a deficit ceiling (which in effect, an external limit on borrowings implies) encounters severe problems. The problems are:

- How is the limit to be prescribed? Should it be in absolute terms or in terms of a proportion of GDP or as a proportion of total government expenditure? If the limits are to be written into law in the US fashion, who is to decide what would be the right amount in a budget year - the Parliament or the Ministry of Finance? In the US the Congress has a fully equipped Budget Office. Should the Parliament here have a separate Budget Cell of its own? Or should the C&AG be asked to act on behalf of the Parliament? Would that not give rise to questions which led the Courts in USA to strike down the Gramm-Rudman law as it was originally envisaged?

- Assuming that a limit is agreed upon by the MOF, there are several ways the deficit figures can be "cooked". In US many devices were resorted to in a bid to adhere to the limits, e.g., sale of assets on a lease-back arrangement or by drawing upon social security surpluses, in our case, oil surpluses may play a similar role - and so on. The Government can also beat the limits by simply passing on its borrowing programmes to the public sector enterprises as indeed it has been doing of late (NTPC bonds and so on). Who would adjudicate as to whether the limits have in fact been respected in case Parliament does not accept the MOF figures? The Courts or the C&AG?
- If in a particular year, the Parliament decides that the limits have indeed been crossed, overruling the MOF, what would be the consequence? Should the borrowings in excess of the limit be paid back? Which expenditure would be subjected to cuts in such an eventuality?
- In the US case, the President can veto a Congress resolution without toppling the Presidency but in India, the Parliament overruling MOF would imply no confidence in the government. Would that be acceptable to the ruling party? If not, then by implication, the Government's estimates of deficits or the actuals would always prevail so long as it enjoys a majority in the Parliament. What then would be the significance or usefulness of the limits in reality?
- Assuming that the broad principles of deficit computation are agreed upon by the MOF and the Parliament (a dichotomy difficult to conceive in the Indian situation), the limit of the deficit has to be flexible since no one can foresee

the growth of revenue and expenditure in a year accurately in advance. After all the budget is only an estimate. Projecting revenues and expenditures correctly is particularly difficult in a country like India prone to natural calamities like droughts and floods. Even in USA a margin was allowed. What would be the margin in our case? Should the government have to go to Parliament every time it exceeds the limit and go through the processes of a constitutional amendment? If that is not possible, will across-the-board cuts be acceptable?

Theoretical Objections

Although the need to contain budget deficits is well recognised, strong reservations have been expressed by many renowned economists against any constitutional limit on the deficits or mindless cuts in government spending. To quote James Tobin, one of the most respected economists of the post-Keynesian era:

"The Gramm-Rudman 'solution' to the nation's deficit problem does not restore fiscal policy to effective partnership in demand management. On the contrary, it is likely to be the coup de grace - if it really takes effect, and at least as long as it lasts. Of course, it was already true that the sheer magnitude of the structural deficits ruled out counter-cyclical fiscal policy for all practical purposes; certainly any extra fiscal stimulus to combat recession is now unthinkable. Gramm-Rudman not only formalizes that incapacity but makes matters worse. In case weakness of the economy adds to prospective deficits, the legislation mandates additional expenditure cuts to meet the prescribed schedule for reduction of the deficit (actual, not

structural). Such cuts would tend to make the economy weaker still. Thus the built-in fiscal stabilizers that served us well for forty years are to be replaced by mandatory destabilizers. There are, to be sure, some escape hatches in the law, but they are inadequate to prevent the perverse responses just described."²

A constitutional cap on deficits not only undermines the potency of the fiscal policy for macro-management of the economy but also weakens the ability of the government to face emergencies like external threat.

Apart from its shortcomings from the macro-management angle, proponents of constitutional limit on deficit tend to overlook the fact that all expenditures of the government have to be approved by Parliament and the government has to go to Parliament for any appropriation beyond the approved amount. Parliament, if it so desires can apply the cuts when any such proposal comes up. The fact that some legislators who would be expected to vote for a limit on government's deficits plead for schemes involving large outlays shows that these inconsistencies seldom bother them. As John Rhodes, Co-Chairman of a Committee for a Responsible Federal Budget in USA put it, "The budget deficit problem we face today results from conflicting priorities and is compounded by an imperfect budget process".

If the country and the Parliament really want to contain the deficits they should decide the priorities. It should also be recognised that the legislators cannot have spending programmes which benefit their constituencies and at the same time prescribe limits on deficits.

This is not to deny that Gramm-Rudman has had some beneficial impact. It has clearly slowed down the growth of government spending. It has generated some awareness of the need to observe revenue neutrality in major tax reform. But it also encountered acute problems. In the Indian constitutional set-up the problems can be even more intractable and bring the functioning of the government to a halt, nor to mention the severe setbacks it may cause for development programmes. The budget crisis that overtook the USA in the last few days bringing the government to a halt bears this out in a dramatic manner.

The right remedy for containing the deficits thus is not a rigid constitutional rule but an awareness of the problem and a consensus about which items of expenditure can be cut. An across-the-board cut in spending apart from being unworkable can spell the end of all development activities of the public sector for it is these outlays which will suffer the cuts in the first instance and expenditures which benefit powerful community groups will almost certainly remain outside the purview of the cuts. Experiences of several European countries show that such mindless cuts (which take no account of the nature of the programmes affected) do not ultimately serve to contain the deficits (as they slow down growth and thereby revenue accretion) and prove counterproductive.

References

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2. Policies for Prosperity : Essays in A Keynesian Mode (1987), by James Tobin, p.33.

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