

Planning for a Budget Surplus

by Dr. Richard E. Wagner

In its coming session, Iowa's General Assembly will consider a constitutional amendment that would limit the state's budgeted expenditures to 99 percent of its projected revenues. Like most states, Iowa now requires its projected budget to be balanced. The proposed amendment would simply replace the projected balance with a projected surplus of at least one percent.

A one percent difference might seem like a small matter. When judged from the perspective of any single year, perhaps it is. For a state to plan to spend less than it collects, however, is a significant change in its mode of operation. It is plausible to expect that this simple change will make a significant difference as the years pass. Large accomplishments can be forged from small beginnings.

What must be recognized is that a balanced budget requirement actually contains a bias that leads to rising taxes over time. The proposed shift to a projected surplus would resist this bias. The budgetary process starts with a projection of revenues for the coming fiscal year. This is true now and will remain true under the proposed amendment. This projection emerges out of the work of a bipartisan conference that involves a number of accountants, economists, and statisticians. This revenue-estimating conference develops a relatively technical projection of revenues for the coming fiscal year. This projection of revenues sets the limit for budgetary appropriations for that fiscal year.

It is here where the politics of appropriations, and of taxation, starts. Under the present balanced budget requirement, appropriations cannot exceed projected revenues. Under the proposed amendment, they could not exceed 99 percent of the projected revenues. In this seemingly slight, one percent difference lies the ability to make a significant difference in state tax burdens as the years pass.

This ability can be seen clearly in the light of three facts of budgetary life. The first fact is that it is nearly impossible for governments to plan to spend less than they collect in revenues. Governments will not plan for budget surpluses unless they are required to do so. Whatever revenues are projected to accrue will be fully appropriated.

The second fact of budgetary life is that revenue projections are never exact. In some years actual revenues will fall short of the initial projections, while in other years the reverse will be true.

The third fact is that promised appropriations are rarely taken back. Should actual revenues fall short of projections, there are two options. One is to reduce appropriations. The other is to increase taxes. The natural tendency of government is to spend all the revenue it collects, and then to seek supplemental appropriations and new taxes to cover any gaps that might arise. Governments have shown little capacity either to accumulate surplus funds or to reduce expenditures when confronted with revenue gaps. A state that operates with a balanced budget requirement will thus find itself confronted periodically with revenue shortages that will be covered through increased taxation. Total tax burdens within the state will thus rise in ratchet-like fashion, even though the balanced budget requirement is widely thought to be a way of getting the state to live within its means.

The proposed constitutional amendment would require the state to plan to spend one percent less than what it projects to collect in revenues. The result of this will be to keep taxes lower in future years than they would otherwise have been, and for two different kinds of reasons. First, gaps between actual and projected revenues can be covered by the built-in surplus. With governments unwilling to significantly pare back expenditures, the one percent cushion the proposed amendment would provide will counteract what would otherwise be a strong drive to increase taxes to cover revenue gaps.

Second, the surplus can accumulate from year to year. So long as the accumulated surplus is less than ten percent of estimated revenues, the proposed amendment allows the surplus to be incorporated into the budget only with 60 percent approval within the General Assembly. A planned expenditure of the surplus, in other words, would be treated as a proposed tax increase. Short of 60 percent approval, the surplus will simply accumulate.

The presence of an accumulating surplus will, in turn, surely strengthen political support for tax reduction, just as surely as the present method of budgeting supports periodic tax increases. For one thing, the accumulated surpluses will not have been promised to particular interest groups through budgetary appropriations. Moreover, the presence of an accumulated surplus will have demonstrated that the state can get by with less than it is collecting. Without being encumbered by pledges to distribute those revenues through appropriations, it will surely be politically far easier to return those revenues to taxpayers as a form of fiscal dividend.

Dr. Richard E. Wagner is Chairman of Public Interest Institute's Academic Advisory Board and is Professor of Economics at George Mason University.

Permission to reprint or copy in whole or part is granted, provided a version of this credit line is used: "Reprinted by permission from INSTITUTE BRIEF, a publication of Public Interest Institute." The views expressed in this publication are those of the author and not necessarily those of Public Interest Institute. They are brought to you in the interest of a better-informed citizenry.