THE BALANCED-BUDGET AMENDMENT DEBATE:
CONSEQUENCES AND EFFECTS

by

KIM DEFFENBAUGH

HONORS THESIS
ADVISER: DR. STANLEY KEIL

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INTRODUCTION

This thesis will explore, scrutinize and evaluate the idea of a constitutional amendment requiring a balanced federal budget. This statement itself will have to be discussed thoroughly, for almost all are not sure or are not in total agreement as to what a "balanced budget" is. One definition of a balanced budget is that tax receipts must equal expenditures for each year. However, this definition is vague and needs more explanation. Does this explanation mean that capital expenditures are not included in the budget that must be balanced? Some 19-20 states throughout this country do not include capital in the budget that must be balanced. And does the definition of a balanced budget that tax receipts equal total current expenditures include interest on outstanding bonded indebtedness? In order for the definition of a balanced budget that tax receipts must equal expenditure to be clear, these two questions must be answered. A different type of balanced budget from the one just mentioned is the cyclically balanced budget. The cyclically balanced budget calls for a cancelling out of deficit spending in recession years by surpluses in boom years. Whatever definition is arrived at, the camps for and against are basically the same. The argument comes from the
debate on whether a constitutional amendment requiring the government to balance the federal budget would be necessary. Would it work? Would it be feasible to design an amendment that could be flexible in economic or national emergencies?

In this paper both the pros and cons of a proposed constitutional amendment to balance the federal budget will be presented. The largest quantity of material that I have found on this subject seems to be against the amendment (surprisingly). However, please do not judge on the basis of quantity; but let the quality of the arguments decide the better (if there is one!) position. Also in this paper will be presented alternatives to the amendment, each side of the amendment having splinter groups who basically favor the position of its main base but believe there are different approaches to the solution.

When I began this project, I had hoped mainly to just present this topic strictly from an economical point of view. This has been impossible—as common sense should have told me. Politics is everywhere, interwoven into every facet of American life. This should not always be a statement of alarm; for while Watergate was a major bruise on this noble profession, politics for the most part are good and healthy. By bringing the economics of the balanced budget into the political arena, its good as well as bad points can be discussed and debated freely and with great thought. I enjoy listening to William F. Buckley, Jr., and his guests debating and discussing topics (while not always comprehending), but
I believe for the most part a majority of Americans do not have the interest or the time to look up the meaning of many words in Buckley's vocabulary. It is good for this important topic of the balanced budget to be discussed by those who are in the limelight, the political actors, for this is a good way to keep the American people informed on the matter. The American people are smart, bright, intelligent and have the common sense to wade through the political "bullshit" which is used by a potential candidate on a subject which has the interest of most Americans, and see what that person is really saying on the matter. This kind of politics, where a candidate jumps on the "right side" in order to attract votes and really says nothing new, is not needed for such an important issue as the balanced budget. The political approach needed here is that in which political actors discuss the topic earnestly without regard to attracting votes.

This paper will therefore be written from both an economical and a political viewpoint. Both sides of the balanced budget question along with alternatives will be presented. In addition, statements on the subject by various people will be questioned and analyzed. Before this main part of the paper is presented, I want to discuss the function, operation and changing structure of the federal budget as presented by Albert T. Sommers in The Balanced Federal Budget: An Orthodoxy in Trouble, George Leland Bach in Bach Economics: Student Workbook, Chapter 15, "Fiscal
Policy and the National Debt," and Thomas F. Diernburg and Duncan M. McDougall in *Macroeconomics: The Measurement, Analysis and Control of Aggregate Economic Activity*. This material given should acquaint the reader who is not familiar with the economics of the federal budget with how the budget and the ideas behind it operate. It is hoped that this material will provide a background for the main part of the paper.

After the main part of the paper has been presented, some conclusions will be given. This paper in no way will presume to decide who is right and who is not enlightened. It is an attempt to search for the truth; perhaps if we are lucky the best answer will await us.

At this time I would like to acknowledge a number of people who have provided me with great support during my four years of undergraduate training. First, I would like to thank my professors at Ball State University, particularly Dr. Paul Humori, professor of Political Science, Dr. Robert Jost, Dr. Abera Zegeye, and especially Dr. Stanley Keil, who was my adviser on this paper. My parents, brothers and sisters encouraged me throughout and I am forever grateful to them. With the love, support, hard work and excellent typing of my fiancee, Edie Willmann, this work has been made much easier.

I would also like to thank those who replied to my requests for information and views on this topic. This information, which makes up a large part of the paper, is
invaluable. Those to whom I am most grateful are: Mr. Richard Moe, Chief of Staff for the Vice-President of the United States, Senator Richard Lugar, Republican from Indiana, Dr. Walter Heller, Professor of Economics at the University of Minnesota, Dr. Milton Friedman, Professor of Economics, a most brilliant and interesting thinker, and the many others who gave some of their time to assist a fellow student.
PART I
THE FEDERAL BUDGET: BUDGETARY PLANNING

It seems that throughout our history we have always equated good government with the government that spends only within its means. Those elected to Congress, state legislatures and even all presidents have always spoken with the deepest convictions that governments should have balanced budgets. This conforms to the preaching that has been geared to the individual that he should not spend more than he earns and that if he does he is spending money unwisely and foolishly and is adding the fuel that stokes the inflation higher. Inflation has been said to have resulted from wasteful, useless spending—an unwise allocation of scarce resources. These same criticisms which have been leveled at individuals have been applied to the federal government's deficits which some say have added greatly to inflation. A balanced budget, besides limiting inflation, fits into the beliefs of many people that government spending should be restrained, and in doing this, the size and power of that government is limited. Allowing a government to spend more than it receives appears to go against the will of the people because more is being spent than the people are willing to provide in funds through taxation.
These simplistic views have described the attitudes Americans have had towards budgetary outcomes over the last few decades—views that have increased in popularity despite a growing recognition that government can have an important role in the well-being of the economy. Government began its increasing role in the economy with Franklin Roosevelt's New Deal and the official stamp of approval was given to government's fiscal policy with the passage of the Employment Act of 1946. This act directed government to influence the level of total demand either through direct spending by the government or by the indirect effect of the effects of taxes on private spending.

What was government attempting to accomplish with the Employment Act of 1946? The purpose was to influence the level of aggregate demand in the economy and keep the economy at a level of full employment while, at the same time, having stable prices. Two terms which should be defined are stable prices and full employment. There are problems with defining each of these terms because there is some disagreement about terms. For the sake of simplicity, stable prices will be defined as an inflation rate of less than 3 percent. Full employment will be defined as an unemployment rate of 4 percent or less, although some economists have lately revised this figure upward.

To better explain the theory behind government's fiscal policy in its role in our economy (how it attempts to reach the goals of full employment and stable prices as it
is directed to by the Employment Act of 1946), the interpre-
tation presented by George Bach in Chapter 12 of Economics
Handbook will be used.

First, the economic theory of fiscal policy implies
that only net changes in autonomous spending have a
multiplier effect on the gross national product. Yet the
full amount government spends is not felt in the multiplier
effect because the amount government spends reduces private
expenditures. How is this done?

In order to better understand the effectiveness of
government economic policy (fiscal and monetary), it will
be useful here to construct an economic model that provides
equilibrium solutions for the many macroeconomic variables
that are of concern. Once the model is completed, an analy-
sis of the effectiveness of government fiscal and monetary
policies in maintaining or working towards full employment
and stable prices can be made. The following discussion is
known as the IS-LM analysis.

The IS-LM model includes both the finished product
and money markets and describes the conditions for equilibrium
to occur simultaneously in both markets. Graphical repre-
sentations (4 quadrant method) along with verbal explanations
will be the method by which the models are constructed.
After the economic model has been completed, government will
then be added to ascertain its possible effects on our
economy.

Investment demand is assumed to be a decreasing
function of the interest rate. In quadrant 1, the investment function is plotted. A savings equals investment equilibrium condition is plotted in quadrant 2. The idea behind the savings equals investment condition is that for the economy to be at an equilibrium income level, savings has to equal investment (when government is introduced later, this equilibrium condition becomes intended investment plus government spending must equal savings plus taxes). Savings as a function of income is plotted in quadrant 3.

By selecting various interest rates and determining rates of income that are consistent with those interest rates, an IS curve can be drawn (quadrant 4). For example, with an interest rate of 5 percent, 25 billion dollars of investment will be made. Moving to the savings-investment graph in quadrant 2, 25 billion dollars of savings will take place. In quadrant 3, 25 billion dollars will be saved at an income level of 150 billion dollars. On the IS curve, an interest rate of 5 percent will be consistent with an income level of 150 billion dollars. If the interest rate slips to 3 percent, a corresponding level of income at 250 billion dollars can be found on the IS curve. The IS curve is a graphical representation of the product market equilibrium condition.

In finding a money market equilibrium, the same procedure used in finding the product market equilibrium can be used. In the first quadrant (Graph p. 2), the speculative demand for money is plotted against the rate of interest.
If there is an interest rate of 3 percent, in this example the speculative demand is 75 billion dollars. The speculative demand for money is the amount of money balances people are willing to hold for reasons unconnected with transaction and precautionary needs. People will hold more speculative balances if interest rates are low. Bond prices would then be high and the purchase of a bond would not be a good investment.

In quadrant 2, the money supply is plotted between transaction and speculative balances. The money supply in this example is 150 billion dollars. The interest rate determines the amount of money available for transaction purposes. At an interest rate of 3 percent, transaction balances will be 75 billion dollars. The speculative demand will then be 75 billion dollars.

In quadrant 3, transaction demands are assumed to be proportional to the level of income at a ratio of 1:2. With an interest rate of 3 percent, there will be 75 billion dollars in transaction balances and this will finance an income level of 150 billion dollars.

In quadrant 4, the rate of interest that is consistent with monetary equilibrium is posted against the level of income. In quadrant 4, the level of income that yields monetary equilibrium with a money supply of 150 billion dollars and an interest rate of 3 percent is 150 billion dollars. If the interest rate moves up to 4 percent, the level of income that will yield monetary equilibrium is 200
billion dollars. The curve drawn out in quadrant 4 by selecting various rates of interest and finding the level of income that is consistent with monetary equilibrium at each rate of interest is known as the LM curve. The curve is a graphical representation of the money market equilibrium condition.

The intersection of the IS curve and the LM curve can only occur at one rate of interest and level of income that is consistent with equilibrium in both markets. The intersection of the two curves occurs here at an interest rate of 4 percent and at a level of income of 200 billion dollars (Graph p. 3).

The economic model is now completed. It is time to determine how effective government policy is in working towards full employment and stable prices. We are now ready to understand why government policy does not always have the full effect that it is supposed to.

If government finances its spending by borrowing, classical economists have claimed that the full amount government spends has no effect on the level of income at all. Why? Government will have to offer a higher interest rate on its bonds than the private sector does in order to persuade people to buy government bonds. The classicalists see no idle money balances in the economy, so government, in order to finance its spending, has to borrow funds from the private sector that would normally be used for private investment. Any increase in government therefore will
be matched by an equal reduction in private investment, a complete crowding-out effect.

To demonstrate this point in graphical terms, I will begin with the 50-billion-dollar level of investment that was used in the making of the IS-LM model. Now add to this a government spending of 25 billion dollars which is financed by the selling of government bonds to the private sector. The level of investment is now 75 billion dollars in quadrant 1 (Graph p. 4), the total amount of injections that are put in the economy. Total leakages must equal total injections, so in quadrant 2 there are now 75 billion dollars of leakage. In quadrant 3, to generate 75 billion dollars of leakage there must be an income level of 250 billion dollars. Moving from quadrant 3 to quadrant 4, at the interest rate of 4 percent there is a level of income of 250 billion dollars. The 25 billion dollars of government purchases has increased the income level 50 billion dollars higher on the IS curve. But does income really increase by 50 billion dollars? By the graph in quadrant 4, the income level is only 225 billion dollars, an increase of only 25 billion dollars. Why does this happen? What could be the further consequences?

The interest rate has now risen to 4.5 percent, an increase of 0.5 percent. The interest rate had to rise in order to induce the private sector to buy government bonds. This implies then that private investment spending will fall. In this case it fell enough to reduce the effect of government spending by 25 billion dollars. But the fall in
private investment does not have to stop here. If an appropriate monetary policy is not implemented, a complete crowding-out effect may occur. It must be noted here that the classicalists view the LM curve as being completely vertical. Classicalists view the LM curve as being vertical because they see no speculative demand for money. The increase of government spending by one dollar may be followed by a decline of private investment of one dollar; there will be no change in the income level at all.

If government finances its spending through taxation, a crowding-out effect will also take place, classicalists claim. Increased taxation will reduce the amount of funds people will have for private consumption and investment. Also, any effort by government to exactly match its spending by increasing taxes may defeat itself because the tax rate increases lower the level of disposable income. Tax collections may not then increase as much as anticipated.

Thomas Dernburg and Duncan McDougall see the classicalists' crowding-out arguments as valid only if the LM curve is completely inelastic with respect to the rate of interest or if the economy was already at a full employment level. But if the economy was in a recession, deficit spending would not crowd out private investment. Deficit spending will only take up the slack left by private investment. The government by deficit spending would put to use idle balances in order to take care of the excess capacity and unemployed labor the private sector left.
Dernburg and McDougall do see some possible crowding out. Some crowding out could occur due to lags from when policy is implemented to when policy has its effects. \(^2\)

Second, fiscal policy also implies that government will be supportive of business by maintaining stable interest rates. If an accommodative monetary policy is not followed, increased government spending (done by borrowing) and a resultant rising income will drive interest rates up and reduce private spending. Crowding out then would occur if expansionary fiscal policies were not accommodated by cooperative monetary policies. But many economists now feel that accommodative monetary policy accelerates inflation, thus creating a policy dilemma.

Third, an expansionary fiscal policy will increase the money GNP. Classicalists say there is no guarantee that this increase will be felt in more jobs rather than in more inflation. The classicalists basically are criticizing the use of fiscal policy by the government in order to increase the income level. They argue that government spending, an expansionary fiscal policy, adds nothing because it crowds out the private sector.

An examination of these arguments will now be made in terms of the IS-LM analysis. Expansionary fiscal policy, because it shifts the IS curve to the right, tends to raise both the rate of interest and the level of income. An expansionary monetary policy shifts the LM curve to the right, lowers the rate of interest and raises the level of
income. Then, if an expansionary monetary policy is implemented with an expansionary fiscal policy, it is possible that interest rates will not be driven up and private investment will not be curtailed.

Congress can make changes in tax levels or government expenditures that can have major effects on the nation's economy (discretionary policy). But there are also automatic, built-in fiscal stabilizers that take effect without any action by Congress or the President. For example, when income falls, less tax receipts will come in and transfer payments go up, and with a set level of spending, this will produce an expansionary budget deficit. This can work in the opposite direction and protect the economy from inflation.

The automatic stabilizers work well against minor problems but to offset major ones, the discretionary policy of spending and tax rates must be used. Government spending is often criticized because of its lack of flexibility and its competing effect with private spending. Fiscal conservatives then tend to favor changes in the tax rate rather than spending. Tax policy is more flexible, exerts less control by the government over the individual's own spending and has a direct effect on the consumers' disposable income. Yet it is also criticized because its effects are smaller than through direct expenditure approach and if people see a tax cut as only temporary, it may not give the desired effect of more consumption but only of increased saving. Also, once the recession is over, Congress—especially during election
years—will be reluctant to raise taxes.

To sustain stable economic growth, government’s attempts to aid the economy must be timed correctly. This is a very difficult task because it implies that Congress and the President recognize an economic problem immediately and then act promptly on the appropriate solutions. I believe that the preceding statement has three impossibilities within it: (1) Congress and the President immediately recognizing the problem (gas shortage); (2) President and the Congress working together (Carter stating Kennedy full of "baloney" and House of Representatives "cowards"); (3) imposing quick solution (coherent energy policy?).

For the above reasons, Milton Friedman and other conservative economists have argued that modern fiscal policy does not work. They show evidence of unemployment and budget deficits existing side by side during the 1930’s, 1954-1964, and the 1970’s as the worst case. Supporters of fiscal policies argued that these deficits were caused by too high tax rates which depressed the economy and brought in tax receipts below the government spending levels. The Laffer curve argument has been used by followers of the idea that tax rates were too high. The Laffer curve shows that above some tax rates, tax collections will actually fall short of what was collected at lower rates. The reasoning behind this argument is that higher tax rates reduce the incentive to work and invest, thus lowering the
the level of income available to tax. The government tax rates, at this time (1970's), they argue, had exerted a fiscal drag on the economy because had the economy been operating at full employment with the existing tax rates and expenditure levels, there would have been a budget surplus. The idea put forth in the preceding statement is known as the full employment budget or full employment surplus. In the full employment budget, taxes and expenditures are arranged as to yield a balanced budget at full employment. The full employment budget during a recession generates stimulative deficits in order to pick the economy up.

Bach states that it is not necessary for a government's budget to be balanced at full employment. A policy of a balanced budget seems only appropriate when the economy is at full employment and private saving equals private investment. Yet in a recession when tax receipts fall, a policy of balancing the budget would call for an increase in taxes and/or a decrease in expenditures. Either of these policies would worsen the recession. During inflation, a balanced budget would require increases in spending or cuts in taxes, thus enlarging the inflation. The annual balanced budget then seems from this information to be a poor policy.

A cyclically balanced budget says government should have surpluses during boom periods and deficits during recessions and over the course of time they would cancel each other out. The problem here is making sure that the deficits exactly equal the surpluses and deciding what
period of time this concept covers (5 years, 10 years, 20 years, 100 years?).

Some people today are advocating a fiscal policy called functional finance. They say forget about a balanced budget as a separate goal and concentrate on using the federal government to provide full employment without inflation, not caring about surpluses or deficits that result.³

This seems to be the policy that has been utilized in the United States for the last twenty years. As long as deficits were small or closely related to war or a recession, there was not much uproar about the deficits. But the huge deficits of the last four years have caused a great alarm since they were not related to war or recession. This new fiscal policy has not really tended to cure either high rise inflation or high unemployment, a paradoxical outcome that leaves most economists bewildered.

Why does this paradox happen? What are the causes and consequences of large and continuing budget deficits?

It was part of this new thinking that budget deficits were a form of public investment and therefore stimulative to the private sector—increase income and become partly self-liquidating in time. On the other side, it was thought that budget surpluses were considered to be anti-inflationary and perhaps even deflationary.

Yet the history of the budget after World War II suggests that budget deficits have grown less stimulative to
the private sector over a period of time and that budget surpluses have grown more restrictive--likely to produce recession. What has caused the budget outcomes to have adverse effects?

There has been a marked relative decline of direct purchases of goods and services and a rise in the number of transfer payments to individuals and to state and local governments. In 1977 transfer payments accounted for 41 percent of the federal outlays while goods and services expenditures were only 34 percent.

A second reason why budget outcomes are not producing the desired results they are meant for is because now government outputs are not keeping up with government purchases. The government has become a net importer of goods and services (the output of the federal government is mainly services it provides, including the services of its employees). Federal purchases of goods and services as a percentage of the nation's total gross product ranged from about 5.5 percent in 1947 to 15.7 percent in 1977. The output on the other hand in 1977 was 4.2 percent of GNP. Transfer payments to state and local governments as grant-in-aids ranged from 4.2 percent in 1954 to 16 percent of the GNP in 1977. 4

So if it is accepted that direct purchases of goods and services from the business sector exert a larger multiplier on private economic activity (and hence on the tax base) than compensation of employees and transfers, then it should be concluded that aggregate federal outlays are no longer as stimulative as they were one or two
decades ago, and as a corollary, that budget deficits themselves are no longer as stimulative, and hence no longer as self-correcting, as they were.\textsuperscript{5}

Any attempt to seek a balanced budget, it would seem, would be more deflationary than it was ten or twenty years ago. The road to a balanced budget seems pretty rough now since transfer payments play such a big part of the budget.

**The Federal Debt**

Besides trying to limit inflation, many people want a balanced budget because they fear the rising federal debt. Total federal debt is the accumulated total of all years of surpluses and deficits. The public also perceives the growth of the debt in postwar years as an indication of bad management by the government and a principal cause of inflation.

Albert Sommers believes that people worry too much about the term public debt. The federal debt is different from business or private individual debt and even state government debt. The federal debt obligations are backed by full faith and credit by a powerful nation that can create its own funds to meet the bills.

"Between the years of 1947 to 1974 the relationship of the federal debt to national output declined persistently."\textsuperscript{6} The debt fell from over 100 percent in 1947 to less than 40 percent of the GNP in 1974. The debt has risen to over 40 percent because of the huge deficits of the last five years.
State and local debts on the other hand rose faster than national output. Private debt by individuals in relation to GNP rose by 170 percent in 1974. All debt together (federal, state, local or private) rose to about 225 percent of GNP in recent years.

Continuous growth of the debt along with the growth of the normal value of output appears to be a basic fact of life if the country is to remain at full employment. When private debt is restrained, unemployment begins to result, budgeting deficits by the government grow to maintain the increasing rate of the aggregate debt.

Some conclusions about the federal budget should be drawn. The budget of the federal government is very complex, encompassing social and economic conditions that cannot be handled by a simple, all-exclusive rule. Many parts of the budget are not really controllable by the federal government.

If the true goals of an economic system are to be achieved—full employment, low and stable inflation, strong and long-term growth rate, high rate of private investment—these objectives depend upon pragmatic action, not some fixed doctrine that ties you into a situation which has no alternatives.
PART II
BALANCED-BUDGET AMENDMENT: PROS AND CONS

This section of the paper will deal with presenting both sides of the issue on whether a constitutional amendment to balance the budget would be a wise economical policy. One can surely see from public opinion polls that it would be a wise political policy; but that is not the concern here. Also presented in this section along with the pro-amendment side will be an alternative suggestion proposed by Milton Friedman.

One point needs to be made clear before proceeding. There are very few—if any—who are against a balanced budget (if economic situations permit it). There are probably none who are for wasteful spending and a misallocation of resources. The difference in opinion on this matter is whether the principle of a balanced budget should be locked in year after year to government's budget or if it is not mandated strictly to every year, is it possible to write an amendment that would allow Congress the discretion on whether to have a deficit in case of a recession or other emergency. These are the questions that will be addressed in this section. The answers to these questions will come in the Conclusion, Part III, from analyzing the material
presented in this section.

**The Case for the Constitutional Amendment to Balance the Federal Budget**

An Associated Press NBC poll shows that Americans are overwhelmingly in favor of a constitutional amendment that would require the federal government to balance its budget. Of those polled on February 5 and 6, 1979, 70 percent favored such an amendment, 18 percent opposed the move and 12 percent were not sure. With such a large majority of Americans backing such a move, it would be wise to examine what they are asking for. What is the case for those who favor a constitutional amendment to balance the federal budget?

Dr. Arthur F. Burns, a Distinguished Scholar in Residence of the American Enterprise Institute and former Chairman of the Board of Governors of the Federal Reserve System, gave some convincing arguments for the case of the constitutional amendment to balance the budget in front of the Subcommittee on Monopolies and Commercial law of the Committee on the Judiciary of the U.S. House of Representatives. The following is a summary of Burns' views as presented before the Subcommittee.

Many people are alarmed at the growth in the federal government expenditures. There has been an explosion, a wide expansion of federal government spending in education, defense, social security programs, highways, health, grant-in-aids and revenue sharing to local communities. Yet
despite all this spending, unemployment remains high, inflation is often in double digits, crime rates rise higher and higher, urban decay increases and many people rely more and more on government assistance. Proposition 13 and bills like the Kemp-Roth bill are cries of hard-working people who see their paychecks getting smaller while the economic situation gets worse.

How does the federal government get the money to pay for all these programs? When the federal government is finished "soaking" the taxpayer, on deficit budgets the government has to finance its spending by borrowing. This borrowing can be done by selling government bonds to the private sector. The federal government therefore cannot really finance its own programs. By borrowing the federal government is expanding the credit market, thereby increasing the money supply. The government is putting out more money than it takes in, fueling the fire of inflation.

When government spends excessively, it cuts out a section that private investment could be in. Many people believe that the private sector of our economy is the strongest and is the key to the fulfillment of our economic goals. Governments by financing deficits then weaken the private sector of the economy, thereby seriously damaging the fulfillment of our economic goals.

Why then do people want a constitutional amendment to balance the federal budget? The rampant double-digit inflation this country has been going through the last four
years had made people grow fearful of big government and less confident in the government's ability to solve economic problems, especially by what the people see as excessive, wasteful spending that does not produce the results they were intended to. Some type of action is needed to cure this inflation and soothe the people's fears about big government.

The constitutional amendment to balance the budget is seen by many as the action needed to restore the private sector's strength, cure inflation and limit big government. Some people see serious difficulties in such a measure, saying that the government would be put into a fiscal strait-jacket that would be extremely damaging in a recession or war. But proponents of this measure say that this difficulty can be taken care of by a two-thirds vote of each house of Congress that would suspend the balanced budget requirement.

The balanced budget amendment is also criticized because some say that it cannot really prevent excessive government spending because all Congress would have to do is increase the tax rates. Yet this criticism cannot hold its own weight in the paper it is written on now, especially in light of Proposition 13 and the Kemp-Roth bill. Opposition to the existing tax votes are so intense now that it is not likely that Congress (especially the House, whose representatives are elected every two years) will raise taxes in the future.

Many people criticize the amendment on the grounds
that government revenues may fall short of what was expected. There have been resolutions in Congress that go with some of the budget amendments that would handle this problem. Congress could set a limit, i.e., 1-3 percent of unplanned excess spending, and allow this to conform to the idea of a balanced budget. Or they could vote by two-thirds to remove the constraint. There can be flexibility in the amendment. The amendment is needed because federal deficits are a major cause of inflation; stable prices are needed if the economy is going to be on sound ground again.7

Senator Richard Lugar, Republican from Indiana, has spoken out often in favor of the constitutional amendment to balance the budget. The following resolution has been submitted by the Senator in the first session of the 96th Congress:

Joint Resolution

Proposing an amendment to the Constitution that Congressional resolutions setting forth levels of total budget outlays and federal revenues must be agreed to by two-thirds vote of both Houses of the Congress if the level of outlays exceeds the level of revenues.

Resolved by the Senate and House of Representa-
tives of the United States of America in Congress
assembled (two-thirds of each House concurring
therein), That the following article is proposed as
an amendment to the Constitution of the United
States, which shall be valid to all intents and
purposes as part of the Constitution when ratified
by the legislatures of three-fourths of the several
States within seven years from the date of its
submission by the Congress:

Article--

On the question of agreeing, in either the House
of Representatives or the Senate, to a concurrent resolution of the two Houses of the Congress which sets forth an appropriate level of total budget outlays of the Federal Government for a fiscal year and a recommended level of Federal revenues for that fiscal year or of agreeing, in either the House of Representatives or the Senate, to a report of a conference committee on such a concurrent resolution, the affirmative vote of two-thirds of Members present and voting (a quorum being present), shall be required for agreeing to the question, if the appropriate level of total budget outlays set forth in such concurrent resolution or recommended in such conference report exceeds the recommended level of Federal revenues set forth in such concurrent resolution or recommended in such conference report. 8

Senator Lugar has been very active in promoting and defending the constitutional amendment. He has spoken to a number of groups and state legislatures on the matter. The following information is a summary of Lugar's views given before the Committee on Constitutional Reform of the New Hampshire House of Representatives on April 2, 1979 (this information speech was supplied on request from Senator Lugar's office).

By April 2, 1979, Indiana, Lugar's home state, had become the 29th state to call for a balanced budget amendment, leaving the total just five short of the necessary 34 needed to call a constitutional convention. Senator Lugar was appearing before the New Hampshire legislature in an attempt to persuade them to do as Indiana had just done. Senator Lugar does not see the Congress as having the initiative or the courage to get this amendment going, so the state legislatures must take the first step.
Lugar stated:

Congressmen and special interests who are threatened by this amendment have begun a campaign of scare tactics and intimidation; even the White House has joined in the unseemly spectacle of mobilizing various special interests against the expressed wishes of the overwhelming majority of the American people.9

There were three main ways in which this has been done.

First, there have been threats from Capitol Hill of punitive federal action against the states, such as cuts in vital programs such as social security, welfare programs, jobs programs, grant-in-aids and revenue sharing programs that aid state and local development. Lugar sees these threats as bluffs. There are too many in both the House and the Senate whose political careers depend on these programs. The Senator points out that governors would be willing to lose some categorical grant programs through which the federal government controls areas that states should decide for themselves. "Individuals in this country stand to gain far more from a stable dollar than they stand to lose from a reduction of what is loosely termed federal assistance."10

A second scare tactic alleges that the poor would be hurt by a balanced budget amendment. Lugar responds to this criticism by saying that inflation, "the hidden tax," is what really victimizes the poor. The common working man is so over-burdened by double-digit inflation and high taxes, he can barely get by. Many people then want Congress to change its attitudes on spending and stay within their proper limits.
The third threat seen by the constitutional amendment opponents is that they believe the constitutional convention called to design such a measure would get out of control and propose amendments on school busing, prayer in schools and abortions, perhaps eliminating the Bill of Rights itself. Concerning this matter, Milton Friedman states:

There is little reason to fear that a convention would propose irresponsible amendments. Delegates to the convention would be elected from all over the country, as Congress is elected. A few "kooks" might get by, as a few get into Congress. But the bulk of the delegates would be responsible people who would take their high and historic trust seriously.11

Lugar responds by saying that such a statement is a direct criticism of the American people themselves, implying that they would be so fanatic as to elect representatives who are so one-sided. (The Attorney General, Griffin Bell, has issued a Justice Department ruling that in their legal opinion the convention would be limited to just drawing up an amendment that would balance the budget.) Also this ignores the fact that any proposed constitutional amendment coming from the convention would have to run the course of approval by 38 state legislatures. Backers of the Equal Rights Amendment have discovered how difficult that task is. Lugar thus feels the fear concerning a convention is greatly overstated.

Senator Lugar closed his testimony with the following quote of James Madison, often known as the "Father of the Constitution:"

"That useful alterations (in the constitution) will be suggested by experience could not be foreseen. It was requisite, therefore, that a mode for introducing them should be provided. The mode preferred by the convention seems to be stamped with every mark of propriety. It guards equally against that extreme facility, which would render the constitution too mutable; and that extreme difficulty, which might perpetuate its discovered faults. It, moreover, equally enables the general and state governments to originate the amendment of errors, as they have been pointed out by the experience on one side, or on the other."12

Allies With a Different Solution

There is a group of people who sympathize with the pro-balanced-budget group, but believe the budget-limitation people are heading in the wrong direction. The group and its economic spokesman that offer a different solution to excessive government spending is the National Tax-Limitation Committee and economist Dr. Milton Friedman. They say that what is needed is not a balanced budget amendment, "but an amendment to limit government spending as a fraction of income."13 State budget limitations, Friedman points out, have not prevented taxes and spending from rising faster than the individual's income, so a federal balanced budget amendment would not do it either. Friedman points out that a better way to fight inflation, therefore, is to have a spending limit amendment and this is what he predicts the budget convention will ultimately propose. The National Tax-Limitation Committee has come up with such an amendment, which was published in its January 30, 1979, newsletter. Following is the proposed amendment and a discussion provided by the National Tax-Limitation Committee:
A PROPOSED CONSTITUTIONAL AMENDMENT TO LIMIT FEDERAL SPENDING

Prepared by the Federal Amendment Drafting Committee
W. C. Stubblebine, Chairman

Convened by The National Tax Limitation Committee
Wm. F. Rickenbacker, Chairman; Lewis K. Uhler, President

Section 1. To protect the people against excessive governmental burdens and to promote sound fiscal and monetary policies, total outlays of the Government of the United States shall be limited.

(a) Total outlays in any fiscal year shall not increase by a percentage greater than the percentage increase in nominal gross national product in the last calendar year ending prior to the beginning of said fiscal year. Total outlays shall include budget and off-budget outlays, and exclude redemptions of the public debt and emergency outlays.

(b) If inflation for the last calendar year ending prior to the beginning of any fiscal year is more than three per cent, the permissible percentage increase in total outlays for that fiscal year shall be reduced by one-fourth of the excess of inflation over three per cent. Inflation shall be measured by the difference between the percentage increase in nominal gross national product and the percentage increase in real gross national product.

Section 2. When, for any fiscal year, total revenues received by the Government of the United States exceed total outlays, the surplus shall be used to reduce the public debt of the United States until such debt is eliminated.

Section 3. Following declaration of an emergency by the President, Congress may authorize, by a two-thirds vote of both Houses, a specified amount of emergency outlays in excess of the limit for the current fiscal year.

Section 4. The limit on total outlays may be changed by a specified amount by a three-fourths vote of both Houses of Congress when approved by the Legislatures of a majority of the several States. The change shall become effective for the fiscal year following approval.

Section 5. For each of the first six fiscal years after ratification of this article, total grants to States and local governments shall not be a smaller fraction of total outlays than in the three fiscal years prior to the ratification of this article. Thereafter, if grants are less than that fraction of total outlays, the limit on total outlays shall be decreased by an equivalent amount.

Section 6. The Government of the United States shall not require, directly or indirectly, that States or local governments engage in additional or expanded activities without compensation equal to the necessary additional costs.

Section 7. This article may be enforced by one or more members of the Congress in an action brought in the United States District Court for the District of Columbia, and by no other persons. The action shall name as defendant the Treasurer of the United States, who shall have authority over outlays by any unit or agency of the Government of the United States when required by a court order enforcing the provisions of this article. The order of the court shall not specify the particular outlays to be made or reduced. Changes in outlays necessary to comply with the order of the court shall be made no later than the end of the third full fiscal year following the court order.
A PROPOSED CONSTITUTIONAL AMENDMENT TO LIMIT FEDERAL SPENDING
Prepared by the Federal Amendment Drafting Committee
W. C. Stubblebine, Chairman
Convened by The National Tax Limitation Committee
Wm. F. Rickenbacker, Chairman; Lewis K. Uhler, President

DISCUSSION

SECTION 1. THE BASIC LIMIT.

The basic limit on federal outlays has two parts. One part applies whenever inflation is three per cent or less, the other part whenever inflation is more than three per cent.

Inflation Three Per Cent or Less. If inflation is three per cent or less, the Federal Government cannot increase its share of gross national product. If, for example, gross national product increases by five per cent from one year to the next, then government spending cannot increase by more than five per cent. Even if government spending increases by the maximum allowed — in this case five per cent — its product merely remains constant.

An important feature of the limit is that it is a linked limit in which each year's limit depends on actual spending of the preceding year. This is the mechanism that permits the Congress gradually to reduce the government's share of the gross national product. If, in any year, the Congress spends at a slower rate than the limit allows, that sets a new and lower base for future years.

Another important feature is the time difference between the fiscal year and the calendar year. Gross national product for any year is not available until some months after the end of the year. The difference in timing makes it possible to calculate the limit in ample time for the necessary budget process. For example, fiscal year 1980 starts in October 1979. The spending limit for that fiscal year would be based on the rate of economic growth during 1978. These data become available early in 1979, just at the moment the federal budgeting process for fiscal year 1980 is getting under way.

The time difference also has a countercyclical advantage. Gross national product increases most rapidly during a boom. This amendment permits the most rapid increase in government spending when the economy is generally over the boom and in a recession — i.e., 21 months beyond the boom peak (21 months is the interval between the start of a calendar year and the start of the succeeding fiscal year). And gross national product increases most slowly during a recession. That brings about a slower increase in government spending 21 months later, when the economy is likely to be past the recession and entering the most rapid phase of the ensuing recovery.
Government spending is defined in this amendment as "total outlays" in order to cover as fully as possible all spending by the government other than debt redemption. Because emergency outlays are excluded, the emergency provision in Section 3 cannot be used to raise the limit for years following the emergency period.

Inflation More Than Three Per Cent. If inflation is more than three per cent, spending still may rise, but the rate of growth will not be quite so fast as the rate of growth in nominal gross national product. Congress, therefore, will have a strong incentive to reduce inflation, to hold down spending, and to cut any deficit. The three per cent cushion provides ample room for unavoidable zigzags in inflation from year to year, and for errors in statistical measurement. At the same time, the inflation penalty in this section establishes a strong pressure for responsible management of the federal budget while not depriving Congress of the necessary flexibility in adjusting to changing conditions. A reduction in the government's share of gross national product should be achieved gradually, to permit an orderly adjustment by employees, employers, consumers and investors. This is why the spending limit is reduced gently — but steadily. Also: the higher the inflation rate, the greater the incentive for Congress to reduce inflation. For example, if real gross national product goes up by four per cent per year and the nominal gross national product goes up by 11 per cent, inflation is seven per cent. The permitted maximum increase in government spending would be ten per cent instead of 11 per cent — a reduction of one-tenth. If nominal gross national product goes up by 15 per cent, inflation is 11 per cent. The permitted maximum increase in government spending would be 13 per cent, instead of 15 per cent, a reduction of slightly more than one-eighth.

For simplicity, inflation is defined as the difference between the percentage increase in the current dollar value of the gross national product and the percentage increase in the real gross national product. This is arithmetically 'slightly different from the usual definition of inflation as the rate of change of the implicit price index. (See "Appendix A".)

SECTION 2. HANDLING OF SURPLUS.

This section simply makes explicit that any surplus must be used to reduce the debt of the United States. The section is fully consistent with current practices regarding management of the public debt. Once the debt is eliminated, this would permit further reductions in taxes.
SECTION 3. EMERGENCY PROVISION.

Any workable limitation on spending must provide for emergency situations, of which the obvious and the most extreme would be the outbreak of a major war. This amendment provides for such situations by building on present practice, under which the President declares an emergency and the Congress may then authorize expenditures in excess of the limit to meet the emergency. In order to deter the use of this provision to thwart the intent of the amendment, the amount of emergency outlays must be specified, the authority must expire at the end of each fiscal year and must be renewed if the need for emergency funds continues, and the emergency outlays may not be included in the base for calculating the spending limit for future years.

SECTION 4. PERMANENT CHANGE.

Because of the year-to-year "linkage" in the limit mechanism, a change in the limit for any single year will affect subsequent years. Such a change should be made only when it has widespread public support. This section, therefore, requires a three-fourths vote of both Houses of Congress plus approval by the Legislatures of a majority of the States.

Though a "change" may, of course, be either an increase or a decrease, this section has to do primarily with increases. The reason is that a decrease for any current fiscal year can be achieved by a simple majority of both Houses of Congress voting total outlays below the permissible limit. However, this section makes it possible for a Congress to ask the States to approve decreases that will apply to one or more future years.

SECTION 5. PROTECTION OF GRANTS TO STATES AND LOCAL GOVERNMENTS.

This section guarantees State and local governments their current share of federal spending for six years. Thereafter, it permits reductions in their share to take place but only if that reduces total federal spending dollar for dollar. It thus avoids any incentive for further concentration of spending in Washington at the expense of the States and local units of government.

SECTION 6. PROTECTION OF STATES AND LOCAL GOVERNMENTS AGAINST IMPOSED COSTS.

This section prevents the Federal Government from imposing costs on State and local governments without compensating them. This closes a loophole by which the limit on federal spending might be circumvented.
SECTION 7. METHOD OF ENFORCEMENT.

The public needs assurance that the spending limit will be enforced. The Judiciary is the established agency of the Government for enforcing the Constitution. At the same time, it is desirable not to abuse the courts with a multitude of nuisance suits. This section allows only Members of Congress to have standing to sue and concentrates these suits in the District of Columbia. Though citizens cannot sue individually, as would be desirable in principle, any of their representatives has standing to do so.

The Treasurer of the United States already is entrusted with the legal responsibility for disbursing federal monies. The Treasurer is now personally responsible for debts exceeding the debt limit. Hence, the Treasurer clearly seems to be the appropriate officer to be named as a defendant and to be charged with the responsibility of carrying out any resulting court order.

This section prohibits the court from specifying the particular outlays to be made or reduced. Such fiscal management is and should continue to be a legislative and executive responsibility. Congress may legislate which outlays the Treasurer shall reduce and by how much. Permitting any correction to be made over a three-year period provides more than enough flexibility.
SIMULATION OF OPERATION OF LIMIT OVER
TEN-YEAR PERIOD WITH STABLE INFLATION OF 8%

Assumptions:
Growth in real gross national product 3.0%
Growth in nominal gross national product 11%
Spending assumed always equal to outlay limit

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<thead>
<tr>
<th>Year</th>
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<th>Spending Limit</th>
<th>Spending as Per Cent of GNP</th>
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<td>21.3%</td>
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APPENDIX A

For example, if the dollar value of gross national product goes up by 11 per cent and real gross national product goes up by four per cent, the rate of change of the implicit price index would be calculated by dividing 1.11 by 1.04, giving an inflation rate of 6.73 per cent, rather than subtracting 1.04 from 1.11, giving an inflation rate of seven per cent. As this example indicates, the two measures of inflation differ by a percentage equal to the rate of real growth. For four per cent real growth, the inflation rate of three per cent used in the amendment amounts to a rate of change of the implicit price index of 2.88 per cent.14
(Simulation for limit assumes total outlays equal to actual outlays or maximum allowed under limit, whichever is lower; assumes receipts equal to actual receipts; assumes gross national product equal to actual gross national product.)

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Cumulative Deficit 1969-78 271.0  - 22.2

*Surplus
EFFECT OF SPENDING LIMIT ON BALANCING THE FEDERAL BUDGET
CUMULATIVE DEFICIT OR SURPLUS, 1969 TO 1978
(Billions of Dollars)

*Simulation for limit assumes total outlays equal to actual outlays or maximum allowed under limit, whichever is lower.
Friedman believes that the budget balancers are actually playing into the hands of the big government spenders. He describes the process as one where spenders pass laws which increase government spending and a huge deficit then results. Fiscal conservatives become alarmed at the deficit so they pass laws which increase taxes to have a balanced budget. As taxes increase, spenders again increase their wants and the cycle is off and running again. 15

What Friedman seems to imply from this is that the cost of the government to the people is how much government spends. If government spends too much it is cutting into the resources of the private sector. Right now that figure, total government spending--federal, state and local--amounts to 40 percent of GNP. Forty cents out of every dollar the working man makes is being spent by government bureaucrats. The people do not seem to get their money's worth; so the solution seems to be to cut down this percentage.

The Kemp-Roth tax cutting bill then is a bill which Friedman heavily endorses. Any bill that cuts taxes as much as this bill calls for would almost automatically have to cut government spending. Yet to make this truly effective, government would have to pass a bill to cut spending also in order to reduce the "hidden tax of inflation." If a spending cut bill was not passed along with such a high tax cut, the government would have to finance
its expenditures by increased borrowing or an increased activity at the money printing press. When the printing method would be used, the tax of inflation would rise. If the government borrowed or taxed, the private sector would lose valuable resources. Also it appears that another hidden tax would be felt because the debt incurred by the deficits would have interest payments that would have to be paid in the future.

There have been charges that a spending limitation amendment would produce dramatic economic crises and is basically undemocratic because it puts the government into a straitjacket on what it can do. The first charge I can dismiss by observing the after effects of Proposition 13 in California. The massive tax cuts did not produce economic crises.

Friedman dismisses the undemocratic charges by using an analogy of the First Amendment and how it limits Congress in that Congress can pass no laws which interfere with our exercise of free speech, religion and press. The same principle then should be applied to a spending limit amendment. It simply says that government has an amount to spend and it can spend no more than that.16

The Case Against the Proposed Amendment to Balance the Federal Budget

The group in this arena, I will again say, is not against balancing the federal budget. They are against the budget amendment, though, for various reasons.
In a letter dated March 26, 1979, by President Carter to Verne Riffe, Speaker of the House of Representatives of the State of Ohio, the President outlines some of his objectives to the proposed amendment.

The President states in his letter that he has been firmly committed to balancing the federal budget, "but by prudent, responsible and equitable spending reductions," not by a constitutional convention. The President indicates that he sees very serious legal, social and economic problems for the country if the amendment is enacted. One such problem is that it would not provide the economic flexibility that is needed during times of economic or national security emergencies. The President states that if the balancing budget amendment would have been in effect during the 1974-75 recession, the economic situation would have been worse, unemployment would have been at 12 percent, and the economy's output would have dropped a drastic 10 percent. In wartime, such an amendment might also prevent the United States from securely defending itself. Even if an amendment could be drafted that had sufficient exemptions, it would become so complicated and complex that it would soon just exist on paper, ignored like Prohibition was.

Carter also states that the Constitution should be reserved only for those matters which cannot be otherwise obtained. The balanced budget, he says, can be obtained by progressing in a prudent, sensible manner. He thereby urged the Ohio legislature to disapprove of any resolution calling
for a balanced budget amendment.\textsuperscript{17}

Paul A. Samuelson essentially agrees with the President's interpretations. He also states:

If the adopted amendment provides escape valves so easy to invoke that the honor of the amendment degenerates into little more than a pious resolution, a rhetorical appendage to clutter up our magnificent historical Constitution. If no escape valves are allowed for, a breakdown in the whole economic system is threatened whenever unpredictable future events prove incompatible with the particular nostrum of 1979 that is frozen into the American charter.\textsuperscript{18}

Law Professor Lawrence H. Tribe of Harvard University prepared a memorandum on January 17, 1979, at the request of the White House on the subject "A Balanced Budget Constitutional Convention." In this paper he concludes that it would be unwise for a balanced budget amendment to be enacted. Why?

The Constitution is a document of general principles; it should not be made to follow specific social or economic goals, especially when those goals could be achieved through Congressional and Executive action. He says the Constitution should only be amended to modify fundamental law, not to accomplish partisan goals.

Another reason why we should not have a Constitutional Convention to write a balanced budget amendment is because of the uncertainties this route of amending the Constitution faces. It could cause widespread division, uncertainty and unrest in the country that is just now getting over Watergate and Vietnam.

He states that the dangers of calling a constitutional
convention together should not involve the familiar scare tactics that they would run hog wild and destroy the Constitution by producing fanatic one-sided amendments. The danger lies in the number of confrontations the convention could lead to due to uncertainties in this amending process.

One of those possible confrontations could be between Congress and the convention.

Congress could, on the application of 34 states calling for a convention, possibly reject some applications as invalid or it could withhold funds needed to finance the Convention until the delegates agreed to internal rules governing their conduct. If the convention refused to follow Congressional orders, a confrontation could flare up that could seriously divide the nation.

In the event that this did happen, this would ultimately lead to a confrontation between the Supreme Court and Congress over its powers relating to Article V of the Constitution. In the case that the Supreme Court would rule in favor of the Congress, a confrontation would develop between the Supreme Court and the States. This country cannot afford the divisiveness that these confrontations would cause.

If such confrontations would take place, there are not now any acceptable answers to the many questions that would occur. Some of the questions that would be expected are:
1. The Application Phase
   A. Must both houses of each state legislature take part in making application to Congress?
   B. By what vote in each house of a state legislature must application to Congress be made? Simple majority?
   C. May a state governor veto an application?
   D. When, if ever, does a state's application lapse?
   E. Must every application propose a specific subject for amendment, or may a state apply to revise the constitution generally?
   F. What of applications proposing related but slightly different subjects or amendments? By what criteria are distinct applications to be aggregated?
   G. May a state rescind its application? If so, within what period and by what vote?

2. The Selection and Function of Delegates
   A. Who would be eligible to serve as a delegate?
   B. Must delegates be specifically elected? Could Congress appoint its own members?
   C. Are states to be equally represented, as they were in the convention of 1787?
   D. Would the one person-one vote rule apply instead, as it does to all legislative bodies except the Senate?
   E. Would delegates be committed to cast a vote one way or the other on a proposed amendment?
   F. Would delegates enjoy immunities parallel to those of members of Congress?
   G. Are delegates to be paid? If so, by whom?

3. The Convention Process
   A. May Congress prescribe any rules for the Convention or limit its amending powers in any way?
B. How is the Convention to be funded? Could the power to withhold appropriations be used to control the Convention?

C. May the Convention remain in session indefinitely? May it agree to reconvene as the need arises?

4. Ratification of Proposed Amendments

A. To what degree may Congress under its Article V power to propose a "Mode of Ratification," or ancillary to its Article V power to "call a Convention," or pursuant to its Article I power under the Necessary and Proper Clause--either refuse to submit a proposed amendment for ratification or decide to submit such an amendment under a severe time limit? What if Congress and the Convention disagree?

B. May Congress permit or prohibit rescission of a state's ratification vote? May the Convention? What if the Congress and Convention disagree?

The unknowable answers to these questions would be sure to cause great strife and division throughout the country. The legal battles in the Supreme Court on these questions could go on for years--the amendment then would die of old age. It seems for this material then that the proposal of such an amendment must come from Congress--if the amendment is to be proposed at all.

More Problems with the Balanced Budget Amendment

Many people see the balanced budget debate as a waste of resources and time. Those who propose amendments do not say how they are to arrive at a balanced budget. These terms should be clearly expressed within the amendment itself.
According to Jude Wanniski, there are four ways in which to arrive at a balanced budget via fiscal policy. One way is to raise federal spending levels whose multiplier effect would go through the economy bringing increased tax revenues, thereby balancing the budget. This policy advocated by Nixon economists did not have much success. The Nixon policy failed in part because the multiplier effect on incomes was not as large as anticipated. Prices rose faster than income; inflation was the result, not a balanced budget.

A second method would be to cut spending levels, but many people believe this would send the country into a deep recession, thereby increasing transfer payments by the government—with the end result of more and larger deficits. (This criticism says nothing about the private sector’s willingness to take up the slack.)

The next approach is to raise taxes. Johnson’s surtax during the Vietnam War did not balance the budget. Carter has attempted to implement a variation of this approach by inflating Americans into higher tax brackets. The inflation is here; the balanced budget is not.

The last option, according to Wanniski, is to lower tax rates; the incentives that result will broaden the tax base and increase revenues enough to balance the budget. (This option encounters trouble because of what Friedman points out earlier in this paper. If a tax cut—which induces the private sector to spend more—is not followed
by a reduction in government spending, inflation increase will be the result.)^{20}

Therefore, Wanniski believes that the debate should be concentrated on the real issue--how it is to be done. The arguing about whether it should be done is the game that politicians are playing in order to win votes.

What if the Opponents of the Amendment Are Correct? Why Do Americans Then Want a Balanced Budget?

Walter H. Heller proposes that Americans have been led into the valley of errors on ways to achieve our valuable economic goals. The public is misinformed; their economic thinking has been guided in the wrong direction by a number of fallacies that they believe in. Walter H. Heller, in testimony given before the Senate Budget Committee of the United States Congress on March 5, 1979, described the fallacies as follows:

1. Individuals, families, and households have to run a balanced budget--so why shouldn't Uncle Sam. People often run up large credit accounts, not sticking to exactly what they want the federal government to do. They are not practicing what they preach.

2. Consumers pay back their debts, so the government should do this also. (This statement can be dismissed according to material presented about the national debt in Part I of this paper.)
3. State and local governments have to live within a balancing budget rule, so the federal government should also. The discrepancy here results from the fact that capital outlays are not included in state and local budgets as they are included in the federal government's budget. One other important point needs to be made here. State and local governments can achieve a balanced budget by suddenly increasing tax rates or cutting expenditures without seriously affecting the national economy. The federal cannot do this without dramatic results.

4. Unlike private and state-local deficit financing, federal deficits are a major, perhaps even the major, source of inflation. Heller disputes this statement. Except when the economy is already at full employment, federal deficits do not cause inflation. During times of recession, increased spending by the government or reduced taxes help to put the economy back to work again.

5. Even if deficits are not as bad as we thought, the federal budget is out of control, and the only way to get it under control is to slap some kind of constitutional lid on it. (This fallacy has already been eliminated by the President's statement to Vern Riff and Dr. Tribe's memorandum)
to the White House.)

6. The balanced budget mandate is a simple, sure-fire way to force the Congress and the White House at long last to match spending and tax revenues.

The proposed amendments have been far from simple. They are difficult to understand and would be extremely difficult to administer due to the loopholes that would allow evasion. 21

The constitutional approach, therefore, is unwise, unworkable and potentially dangerous to our system of government as well as our economic system. This side against the amendment therefore concludes that Congress must come up with some statutory provision that will be responsive to the people's will without putting the government into a strait-jacket that would be detrimental to our government and economy.
There has been abundant material on each side of this question on whether a constitutional amendment to balance the federal budget should be enacted. The following are my own conclusions, gathered from examining and analyzing the data:

1. We do have a democratic government which is supposed to express the will of the people. This is guaranteed by the Preamble to the Constitution. So the following should be done:

(a) Congress should perform its duty and pass a statutory law that will check excessive spending and move the country towards a balanced-budget position. There is no need for a constitutional amendment where the facilities already exist for the principle to be enacted. The Constitutional Convention should be avoided at all cost because of the great uncertainties involved which would surely cause great confrontations and division across the country.
(b) If Congress does not have the courage to assume the responsibility for such an action, it should pass a proposal for a constitutional amendment to limit federal spending as described by Friedman and the National Tax-Limitation Committee. The states then would be responsible for the amendment.

(c) This spending limitation amendment is flexible enough to meet economic crises and national emergencies. It does not put the government into a strait-jacket but instead makes the government more responsive to the will of the people and at the same time it seems it will do a great deal in solving some of the economic problems that exist today.

My conclusions on this material are not intended to attempt to persuade others to agree. The material presented in Parts I and II have been a synthesis of the material available today on the balanced-budget debate. The main objective of this thesis as stated in the Introduction was not to come up with the correct solution, but to present material with which to inform the reader on this issue. Perhaps the reader will see a "middle ground" to the problem, as I tend to do. Conclusions will not come solely from the material presented, but also from the reader's background,
educational surroundings and prejudices. This is unavoidable.

I believe this paper can make a valuable contribution in that I have been unable to locate any other material which has presented the opposing views on this matter in as complete a form as they are presented here.
ENDNOTES


4 Sommers, pp. 8-11.

5 Ibid., pp. 10-11.

6 Ibid., p. 13.


8 A Joint Resolution on a Proposed Balancing Budget Amendment, introduced by United States Senator Richard Lugar of Indiana as S.J. Res. 4 in the Senate of the United States, 96th Congress, 1st session. The Congressional Record.

9 Senator Richard Lugar in testimony before the Committee on Constitutional Reform of the New Hampshire House of Representatives, April 2, 1979, pp. 4-5.

10 Ibid., p. 6.

11 Milton Friedman, "Implementing Humphrey-Hawking," Newsweek, March 5, 1979, p. 87.

12 Senator Lugar testimony before New Hampshire House of Representatives, pp. 11-12.


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------. "Jerry Brown's Kiss of Death." *Newsweek.* March 26, 1979, p. 87.


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Friedman, "Limitations of Tax Limitation," p. 11.

Ibid., pp. 9-10.


Paul A. Samuelson, "Two Views of the Budget-Balancing Amendment," The AEI Economist, April 1979, pp. 4-6.


APPENDIX
Graph Page 1

The Product Market

**Quadrant 1**
$I = I(i)$

**Quadrant 4**
$E = Y - C(Y)$

**Quadrant 2**
$I = S$

**Quadrant 3**
$S = Y - C(Y)$

**Billions of dollars**
**Billions of dollars**
**Graph Page 2**

**Money Market**

**Quadrant 1**
Speculative demand

\[ m_2 = L(i) \]

**Quadrant 4**
Monetary Equilibrium

\[ m_s = kY + L(i) \]

**Quadrant 2**
Money Supply

\[ m_s = m_1 + m_2 \]

**Quadrant 3**
Transactions demand

\[ m_1 = kY \]
INTERSECTION OF IS-LM CURVES
**Graph Page 4**

**Quadrant 1**

\[ I + G = I(t) + G \]

**Quadrant 2**

\[ S + T = I + G \]

**Quadrant 3**

\[ S + T = Y - C(Y - T) \]

**Quadrant 4**

\[ I(t) + G = Y - C(Y - T) \]

LM CLASSICALISTS

ISO

S

S₀