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A Constitutional Mandate for a Balanced Budget

Freedoms Foundation Announces Awards

Dr. Don Diffine, professor of economics and Director of the Belden Center for Private Enterprise Education at Harding University, has been named the recipient of two Freedoms Foundation awards, according to the Independent 1982 National Awards Jury.

Dr. Diffine's awards were announced recently at the Valley Forge National Headquarters of the Freedoms Foundation. In an April awards ceremony in Dallas, Texas, Dr. Diffine will receive the Valley Forge Honor Certificate for Excellence in the Category of Economic Education and the George Washington Honor Medal for an outstanding accomplishment in helping to better understand the American way of life in the Category of Letters to the Editor.

"Free Enterprise — It Works When We Do," a report that chronicles a variety of economic enlightenment projects and programs which have been presented through the Belden Center to civic, professional and educational groups in the Mid-South, was the basis for the Economic Education award. "The Economic Policy Debate — Trickle Down Vs. Siphon Off," a lengthy letter printed in the *Arkansas Gazette*, the *Daily Citizen*, and the United Employers Federation newsletter, the *X-Changer*, was an Awards Jury's selection in the Letter to the Editor category.

Governor's Task Force set

Arkansas Governor Bill Clinton has asked Mr. Del Belden, Board Chairman of Lomanco of Jacksonville, Arkansas, to head up a Task Force to find progressive ways through which the Arkansas prison system could become a revenue generating enterprise. Mr. Clinton has asked the Harding University Economics Team to join the Task Force, to recommend some possible ways that the prison system could be cost effective. The Economics Team will work with Mr. Belden to investigate and report on progressive methods that might be used to convert the Arkansas prison system into a revenue enhancing "factories-with-fences" approach.

by D.P. Diffine, Director
Professor of Economics

Our redistributive society has evolved through three stages. First, we taxed the wealthy, stealing from the rich. Second, through deficit spending and inflation, we used unbalanced red ink budgets to steal purchasing power from the middle class. Third, through over-consumption caused by producing less and demanding more, we stole from our children by providing insufficient capital for economic growth. This has undoubtedly been a sure way to discourage ancestor worship.

Some analysts predict that if Congress continues its policy of committing for programs for which it has no money, 1983 and 1984 may see Federal and Federal-related borrowings actually exceeding net national savings. Such a situation would require either raising taxes or continuing the inflationary policies of the past through expansion of money supply, both of which cause a lower standard of living for people.

A Constitutional balanced budget amendment appears to be our only means of bringing Congress's excessive spending under control. Thomas Jefferson said it best: "... let no more be heard of confidence in man, but bind him down from mischief by the claims of the Constitution."

The notion that we could continually prod the economy into prosperity, through force feeding it with annual budget deficits, has created a noxious mixture of stagnation and inflation that we call "stagflation." We cannot spend ourselves rich. Attempting to do so has drained away the private sector's vitality and has caused scarey combinations of budget deficits, double-digit inflation, and volatile interest rates.

Stimulating demand through Federal spending has spawned evergrowing numbers of special interest groups. And should it be a surprise that each of these groups has vigorously guarded "its" so-called share of the Federal government's budget? More resources must remain with the private sector if America is to overcome its economic problem. We need better control of government spending. Increasing deficits require borrowing by the government; and government borrowing takes away from the amount available for corporate borrowing. There's just so much available.

THE QUESTION BEFORE THE HOUSE

The question becomes this: "Do we want to risk a speedup of inflation and the destruction of our currency by boosting government deficit spending and hampering savings and production, or are we really determined to cut Federal expenditures, curb the growth of the money supply and thus preserve our currency and our economy?" Office seekers have known that many voters realize that increased Federal spending, without corresponding increases in taxation, will increase inflation, and this can lead to recession and unemployment. And so, politicians, whose actual policies and programs would oblige a significantly larger Federal budget, are apt to camouflage this fact.

The basic economic truth is that in the long run, far from "creating new jobs," deficit spending actually throws men out of work. By hogging the supply of credit, the government elbows private firms out of the market. Strapped for funds, businesses languish. And unemployment soars.

Presidents and members of Congress often complain that the Federal budget can't be cut much because the bulk of spending on social welfare programs is mandated by acts of law, hence "uncontrollable." Whatever laws previous Congresses and Presidents have enacted, this Congress and President can repeal. Nothing is really uncontrollable, except perhaps the never-failing instinct for political survival among our public servants.

The real argument about the budget deficits and the quantum leap in the Federal debt stems from the fact that it accommodates and facilitates big government. The liberal favors it, because he likes big government. The conservative opposes it, because he opposes big government. Many of the contentions regarding budget deficits have been contrived out of a desire either to facilitate or restrict the growth of the Federal government.

We need to realize the legacy of fiscal irresponsibility. Runaway, big-spending government is completely out of control. Even a strong President with a clear set of principles finds it politically impossible to do the tough things that must be done to turn our economy around. We seemingly no longer have the necessary national self-discipline to resist voting ourselves more and more benefits from the public trough.

CHANGE THE RULES

Politicians are politicians. They respond to pressure from special interest groups in every Congressional district. As long as the rules allow it, they will spend money as if there were no tomorrow. When tomorrow does come, they'll raise taxes or borrow the money to cover their spending. It doesn't seem to matter who's in the White House or which party controls Congress. Our only real hope is to change the rules — change the system so that politicians can be politicians without dragging the insolvent economy into bankruptcy.

The typical version of a balanced budget amendment would require Congress to enact each year a budget whose outlays did not exceed expected revenues. Peacetime deficits would be allowed only with the consent of three-fifths of both houses. Wartime deficits could be approved by a simple majority. Congress could increase spending substantially from year to year — but only if it were willing to vote for higher taxes. Without such a vote, revenue increases would be held to a pace no greater than the nation's rate of economic growth.

If and when such an amendment clears both houses of Congress, it will have up to seven years to win state ratification. It could become effective no earlier than fiscal 1986. Such an amendment provides the necessary balance between realism and idealism. It should be adopted.

Critics contend that fiscal theory should not be in the Constitution. However, the 16th Amendment authorized the income tax; that was not in the Constitution originally. Currently the Constitution contemplates spending and revenue raising, but it doesn't deal with how much can be spent. Congress could simply pass a statute embodying the same provisions as are in the amendment. However, time and again it has shown they're not willing to balance their books.

There are those who believe that the only response to the present budgetary crisis is election of "responsible" representatives. They fail to appreciate that the Congress is currently made up of such well-intentioned individuals. Justification for the amendment lies directly in the congressional fiscal irresponsibility that has plagued our economy for at least the last two decades.

As with the first ten amendments, a balanced-budget amendment limits the power of Congress to bind the people with excessive taxation and deficit-caused inflation which acts as a tax. The amendment would force members of Congress to identify themselves, by their votes, as deliberate budget busters if they desire to commit funds that will have to be borrowed.

Alas, there is no free lunch. Everything has a cost that must be paid by someone. The Federal government has been shoveling out money for many programs that, until the last two decades, have never been part of its responsibility. Now that such money, heretofore thought of as "free," is potentially being reduced through a budget-balancing amendment, the "victims" are screaming about economic and social injustice. If those programs are in fact important, then the would-be casualties should petition their state legislatures for similar programs. No doubt some of the programs will no longer be so important, if the citizens are asked to pay for them directly.

Good As Gold

by David S. Tucker
Assistant Professor of Economics

Arthur Laffer is for it, but Milton Friedman is against it. Lew Lehrman is for it, but Paul Samuelson is against it, but for different reasons than Milton Friedman. I think Ronald Reagan is for it, but I'm not sure.

I refer, of course, to the gold standard. The proponents of gold assert that such a system will do almost anything including balance the budget, reduce inflation to zero, reduce interest rates to 4 percent, and cause international peace and prosperity. The opponents of the system say, "nonsense" — a gold standard will cause financial panic, deflation, unemployment, and throw our monetary system into the hands of South Africa and the Soviet Union.

Who is right? Well, first we're going to describe the need for a stable monetary standard, then move on to how a monetary standard based on gold would work, then to a study of the history of the gold standard, and finally we'll draw some conclusions.

PROBLEMS, PROBLEMS

August 15, 1971. On that day, the final link between the dollar and gold was formally suspended by President Nixon. The United States, since that time, has been on an irredeemable paper currency standard. Paper money can be issued at will by the government, and since 1971 it seems they have done so. Both the quantity of money and the price level have doubled since 1971.

In 1979 and 1980, America experienced the double whammy of back-to-back years of double digit inflation. These high inflation rates (12 percent for 1979, 13 percent for 1980) fostered even higher interest rates, an anemic savings rate, rising unemployment and general economic deterioration.

In 1980, due partially to the worsening economy, Jimmy Carter was removed from the Presidency and Ronald Reagan was elected. The Republican Party platform of 1980 saw fit to express an affection for a stable monetary policy:

> The severing of the dollar's link with real commodities in the 1960's and 1970's, in order to pursue economic goals other than dollar stability, has unleased hyper-inflationary forces at home and monetary disorder abroad . . . One of the most urgent tasks in the period ahead will be the restoration of a dependable monetary standard.

Why is it so important that we have a stable monetary standard? Eugene A. Birnbaum, an economic consultant from New York put it this way:

> Between the time money is received and the time it is spent, there is always a lapse of time. Sometimes the lapse is a few minutes; sometimes it's a few generations. Unless the holders of money can count on that money keeping its value during those lapses, you will not have a well-functioning economy.

Slats Grobnick put it even more succinctly, "Inflation is the time when people who save for a rainy day get soaked."

Inflation is a disease that affects the very core of traditional American life. America was built on the virtues of hard work, saving, family and faith. Inflation destroys most, if not all, of those values. Savings is the first to go. It's obvious to most that if inflation is 13 percent and you can only earn five percent on a savings account, you're losing eight percent a year by saving. On top of that, the government is going to tax the interest you earn. Smart Americans haven't been saving any money for years.

And what's the point of hard work and faith? It's easier to make some fast bucks by speculating in housing or pork bellies. Instead of fostering decent family virtues, inflation erodes the moral fabric of our society. Indeed, we have now raised a generation of people who have experienced nothing except inflation.

Another quote, this time from Lew Lehrman, a recent candidate for governor of New York:

> . . . above all, inflation fraudulently transfers hundreds of billions of dollars from the weak and honorable to the slick and well-placed. This wealth transfer from the thrifty to the speculator, from the small businessman to the giant government contractor, from the saver to the spender, from the aged and poor to the rich and powerful — violates our religious heritage, makes a mockery of honest work and erodes our faith in Constitutional government.

DOLLARS FOR GOLD

In order to have a gold standard, there are two conditions that must be met:

(1) The currency must be defined in terms of gold.
(2) The public must be given the choice of holding either dollars or gold.

For many years in the United States, the official price of dollar-gold exchange was $35 for one ounce of gold. It is extremely doubtful that if we were to re-implement the gold standard that the price would be $35 an ounce, given that the current world market price of gold is around $400 an ounce. The point is, there must be some defined anchor for judging the value of the currency. As Arthur Laffer recently stated, "It is not gold, but the standard that's important." Its purpose is to provide the central bank with a rule for the maintenance of a stable price level.

The quantity of money, under the gold standard, is determined by people, not an economist in Washington. This is a result of the second condition. Since the public has the choice of holding dollars or gold, if inflation were to rear its ugly head, people would simply go to the bank, turn in their dollars for gold at the specified rate, and thus reduce the quantity of money which would cause inflation to cool. Alan Greenspan, economic advisor to President Ford, put it this way:

> . . . once (the gold standard) is achieved, the discipline of the gold standard would surely reinforce anti-inflation policies, and make it far more difficult to resume financial profligacy. The redemption of dollars for gold in response to excess federal government-induced credit creation would be a strong political signal. Even after inflation is brought under control, the extraordinary current political sensitivity to inflation will surely remain.

NOT WORTH A CONTINENTAL

History is on the side of gold. Whenever the Federal government has seen fit to sever the relationship between gold and dollars, inflation has occurred. In 1775, due to the desperate need for money to finance our Revolutionary War, Congress issued $2 million of continental currency. Curiously, at the outset, two members of Congress were required to personally sign each note issued. This attractive requirement soon became too burdensome, given the Congressional propensity to print. By 1779, $200 million of paper was issued, and even today after two centuries we hear the expression "not worth a continental."

Fortunately, after the Revolution, Congress re-established the link between gold and money. The next problem came during the Civil War. Both north and south set up printing presses to pay soldiers and equipment suppliers. Both experienced highly inflationary economies. After the Civil War, dollar-gold convertibility was restored and continued until, of course, World War I and II. The historical situation following World War II is interesting, if only for the fact that more statistics are available.

Toward the end of World War II, when it was becoming obvious that the Allies were going to win, many economists began to worry about the transition from a wartime to a peacetime economy. They worried that with the influx of soldiers, unemployment would be high; with the decrease in military spending, industry would slump. Harry Truman, however, knew that most of this was nonsense. Given the opportunity and incentive, the soldiers would not be a drag to the economy, they would improve it. Industry would not slump, it would expand. But workers and industry have to be given the opportunity to operate with a stable monetary system, and they must have the incentive to perform.

In order to provide a stable currency, in 1944, President Truman reinstated dollar-gold convertibility. In order to provide incentive, in 1946 personal and corporate tax rates were cut. Arthur Laffer describes the ensuing years:

> "Between 1945 and 1953, private output, real GNP less defense, expanded at an average annual rate of 5.2 percent, the Federal budget was in surplus five out of seven years, Treasury bill rates ranged between 0.4 percent and 1.8 percent and the rate of inflation fell from its post-World War II peak of 20 percent to zero. Think of it in today's context: Inflation was brought under complete control and unemployment never went as high as 6 percent."

IMPLEMENTATION

Although there are some technical problems in reimplementing a gold standard, the technical problems are not unsolvable. They should not impede our progress.

As one person has said, "There are 300 economists in the world who oppose gold and about 3 billion people in the world who believe in gold."

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