

Whalen, Charles J.

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FEDERAL BUDGET BALANCE: TONIC OR TOXIN?
Fiscal Irresponsibility:
The Balanced Budget Amendment of "Contract with America"

by

Charles J. Whalen*

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*Resident Scholar, The Jerome Levy Economics Institute of Bard College

The author acknowledges comments and assistance from Wynne Godley, Triveni Kuchi, Jay Levy, Sanjay **Mongia**, Dimitri Papadimitriou, Max **Sawicky**, **Anwar** Shaikh, **Oren Levin-Waldman**, Linda Whalen and Randy Wray.

Summary

This study presents a critical assessment of the constitutional balanced-budget amendment (BBA) proposed in the Republican "Contract With America" (CWA). The paper is divided into three parts. Part One offers a brief historical account of views toward balanced budgets, a description of the CWA proposal, and an outline of arguments offered by amendment supporters. Part Two develops the case against this amendment. Part Three identifies an alternate direction for budgetary initiatives. While present budget policies warrant reform, the BBA would lead to even greater fiscal irresponsibility. Instead of a tonic, advocates of this legislation propose a political and economic toxin.

The frustration Americans feel toward our federal budget is understandable. But the BBA diverts attention from today's most fundamental budgetary matters. It also invites evasion -- and partisan conflicts on the appropriateness of particular evasions. Thus, BBA enactment would engender more citizen frustration and a further loss of confidence in our government. Other political concerns include the following: (a) the BBA's tax-limitation element is not defensible as a provision that strengthens our political structure; (b) while leaving Congress to enforce the amendment itself renders the change meaningless, court involvement in fiscal matters is not a viable alternative; and (c) it is not at all clear that past deficits have been incompatible with public desires.

The BBA also enshrines a misguided economic policy:

* It ignores the reality of private-sector budgeting. Contrary to the Republican position, it does **not** require Congress "to live under the same budget restraints as families and businesses." It instead mandates an objective that almost no private economic actor could meet.

* It precludes the development of federal capital-budgeting procedures -- ones used effectively by states, localities and even some of our international competitors.

* And it hinders the public-sector's ability to compensate for cyclical fluctuations. A BBA eliminates one of the few mechanisms preventing mild downturns from developing into severe recessions.

A sensible alternative to the CWA proposal involves pursuit of balance in our cyclically-adjusted budget -- in other words, a policy of full-employment budgeting. This policy would specify a clear budget direction while simultaneously avoiding problems created by the BBA. Other reform initiatives worth considering include investment and biennial budgeting and a new bipartisan effort to tackle the problem of entitlement spending.

Passing a BBA might fill us with a sense of accomplishment for a short while, but it ultimately involves little more than "governing by gimmick." As the Concord Coalition concluded in September of 1994, the CWA is about "getting votes, not about balancing the budget."

Introduction

Republicans in the U.S. House of Representatives unveiled a ten-point legislative agenda in September of 1994. The first item in that "Contract With America" (CWA) is *The Fiscal Responsibility Act*, an initiative calling for both a constitutional balanced-budget amendment and legislative line-item veto. The present paper focuses on the balanced budget amendment (BBA) -- which is to be introduced by its own Joint Resolution. In particular, it presents a critical assessment of arguments offered in support of this proposal. While today's budget policies warrant reform, the CWA proposal would lead to even greater fiscal irresponsibility. Instead of a tonic, advocates of this legislation propose an economic and political toxin.

This paper is divided into three sections. Part One provides a brief history of past efforts to enact a BBA, a description of the present proposal, and an outline of arguments supporting this bill. Part Two offers a critical assessment of the case for this amendment. Part Three identifies an alternate direction for budget reform -- full-employment budgeting; it will be argued that a balanced full-employment budget represents a more meaningful objective than that outlined in the CWA.

**Part 1. The Balanced Budget Amendment:
History, Description and Arguments**

The Kimmel Study

In a 1959 report for The Brookings Institution, Lewis Kimmel traced the evolution of budget and fiscal policy from the beginning of the nation to 1958. His study found that until the 1930s, "the philosophy of the annually balanced budget enjoyed virtually universal acceptance" (Kimmel 1959, 1). According to Kimmel, "The principal economic reason advanced in support of the balanced budget was that an increase in public debt involves a draft on funds or savings that otherwise would be available for private capital expansion" (Kimmel 1959, 302). In short, public borrowing was said to slow economic progress by impinging on private investment. While war debt might be permissible, it was the only widely-accepted exception -- and rapid elimination of such debt was expected in peacetime (Kimmel 1959, 301).

The Kimmel study explains that the balanced-budget philosophy was enhanced by an ethical view of indebtedness that pervaded American culture. Reflecting a society in which thrift "ranked among the greatest of individual virtues," citizens frequently asserted that "a public debt is an evil or is immoral" (Kimmel 1959, 58 and 302). According to the study, economists warned that a government which does not habitually rely on revenues to cover its expenses is likely to become "extravagant and irresponsible" (Kimmel 1959, 302).

In the 1930s, however, views toward balancing the federal

budget underwent a "revolutionary change" in both theory and practice (Kimmel 1959, vii). This change led to the concept of *compensatory* fiscal policy -- an approach that "emphasizes the effects of government expenditure and revenue upon the total economy and argues that they should be used deliberately and consciously as a 'balancing factor' to secure economic stabilization" (Kimmel 1959, 7-8). The federal government had assumed responsibility for cyclical stability, and the balancing role of fiscal operations was soon accepted by all but what Kimmel calls "a small minority" (Kimmel 1959, 306). The notion of *balancing the **economy*** replaced that of *balancing the **budget***.

Although Kimmel describes how numerous business and professional leaders changed their position on the balanced-budget issue in the wake of the Great Depression, he also mentions that "an influential minority" continued to regard any departure from a balanced peacetime federal budget "with serious misgivings" (Kimmel 1959, 298). Kimmel writes: "Only a few years ago an amendment to the Constitution outlawing federal deficits in time of peace was proposed in the expectation that it might enforce an annually balanced budget" (Kimmel 1959, 298). To this minority, he explains, federal expenditures are "unconscionably high," and threaten to bankrupt the country, destroy the enterprise economy, and extinguish our liberties (Kimmel 1959, 298-299).¹

The Past Decade

The Kimmel study demonstrates that there have been calls for a balanced-budget constitutional amendment for some time. In fact,

the first of these proposed amendments was offered in 1936. Rising federal deficits in the 1970s and 1980s, however, caused the issue to receive increasing attention during the past two decades (see Table 1). After watching the unified budget deficit nearly double from \$40.2 billion in 1979 to \$79.0 billion in 1981, legislators brought the amendment issue to a vote in 1982. The proposal cleared the Senate by a two-vote margin, but it fell short in the House with a vote of 236 to 187. (A two-thirds majority of each house is required on efforts to amend the Constitution; ratification then requires approval by three-fourths of the states.) The bill failed to pass both houses again in 1986 and 1990.²

Another amendment was considered in 1992. That year, despite the 1985 Gramm-Rudman-Hollings Act that was to have brought the deficit to zero by 1991, the unified deficit was expected to reach \$300 billion.³ At first, momentum behind the bill seemed overwhelming: the House discharged the legislation from committee in record time; *The Washington Post* indicated that most Americans supported the move and that public outrage over political gridlock and the House check-bouncing scandal added to the pressure for passage; and initial vote estimates indicated approval appeared "inevitable" (Dewar and Gugliotta 1992, A14). But by early June, Washington newspapers were reporting that lobbying against the measure was proving effective and prospects for the amendment had grown dim (Clymer 1992).⁴ The 1992 initiative died later that month when it failed to pass in the House.

Authors of the leading 1992 proposal, Senator Paul Simon (D-Illinois) and Representative Charles Stenholm (D-Texas), reintroduced the measure again last year. Indeed, a number of versions were debated in the House, and two major alternatives were considered by the Senate. On March 1, the Senate fell four votes short of passing the Simon amendment. On March 17, House action on the Stenholm bill fell short of the required two-thirds majority by 12 votes.

TABLE 1.
FEDERAL SURPLUS OR DEFICIT (-), SELECTED FISCAL YEARS 1960-95

Fiscal Year	Billions of Dollars	Percentage of GDP ¹
1960	0.3	0.1
1965	- 1.4	- 0.2
1970	- 2.8	- 0.3
1975	- 53.2	- 3.5
1980	- 73.8	- 2.8
1984	- 185.4	- 5.0
1986	- 221.2	- 5.2
1988	- 155.2	- 3.2
1990	- 221.4	- 4.0
1992	- 290.4	- 4.9
1993	- 254.7	- 4.0
1994	- 203.4	- 3.1
1995 ²	- 165.1	- 2.4

Sources: Economic Report of the President, February 1994;
Office of Management and Budget, December 1994.

¹GDP -- Gross Domestic Product

²Estimate

The "Contract With America" Proposal

The balanced-budget provision of "The Fiscal Responsibility Act" would amend the U.S. Constitution to require that "total outlays for any fiscal year do not exceed total receipts for that year" (House Republican Conference 1994b, 4). The resolution defines *total receipts* as "all receipts of the United States except those derived from borrowing" and *total outlays* as "all outlays of the United States except those for the repayment of debt principal" (House Republican Conference 1994a, 3). Under this proposed amendment, balance would be required at the time of budget submission (by the President), adoption (by Congress), and execution.⁵ The amendment outlines only three circumstances under which deficits are allowed: 1) when a declaration of war is in effect; 2) when a joint resolution -- signed by the President and adopted by a majority of the total membership of each house -- indicates that the nation faces an "imminent and serious military threat to national security;" and 3) when Congress approves outlays in excess of receipts by a vote in which three-fifths of the total membership in each house agrees to the deficit (House Republican Conference 1994a).

The bill stipulates that the federal public debt will be limited to its level on the first day of the second fiscal year after ratification. That limit may be increased only by a three-fifths vote in each chamber. Legislation to increase receipts must also be approved by a three-fifths majority of the membership in each house (which has led some to call the proposal a "balanced-

budget/tax limitation amendment"). Finally, the amendment mandates that all associated votes must be roll-call votes, and that the requirement will take effect in Fiscal Year (FY) 2002 or the second fiscal year after ratification (whichever is later).

The Case For the Amendment

The CWA states that a balanced-budget/tax limitation amendment is needed "to restore fiscal responsibility to an out-of-control Congress, requiring them to live under the same budget constraints as families and businesses" (CWA 1994). A Republican National Committee description of the contract insists: "It's time to force the government to live within its means and restore accountability to the budget in Washington" (Republican National Committee 1994).

The House Republican Conference *Legislative Digest* adds:

Supporters of a BBA argue that Congress has shown itself both unwilling and incapable of balancing the federal budget. A constitutional amendment is necessary to force lawmakers to do what, on their own, they cannot: get a handle on out-of-control spending (House Republican Conference 1994b, 1).

The argument that a constitutional requirement is necessary to ensure "fiscal responsibility" has been emphasized by many during recent BBA battles. In 1992, for example, Senator Simon wrote:

The amendment would make fiscal responsibility the general rule instead of the rare exception. This is needed because the political will to reduce the deficit is absent in the White House and in Congress. Critics wish for the day when our leaders will come to grips with the deficit crisis without a constitutional crutch. But danger is upon us (Simon 1992).

One "danger," Simon explained, was that "virtually every major area

of policy is being squeezed or ignored because of runaway interest payments." Another was that the budget deficit discourages industrial investment (Simon 1992).

Simon's concern about industrial investment is probably the economic point raised most often in discussions of the need for budget balance. As Federal Reserve chairman Alan Greenspan put it in a 1989 article, deficits have a "corrosive" effect on the economy because they dampen economic activity by triggering the following series of events: resources are pulled away from net private investment; the rate of growth of the nation's capital stock is reduced; productivity gains are less than would have otherwise been the case; and the growth of our standard of living is similarly impaired (Greenspan 1989). Many BBA supporters also maintain that deficits reduce exports (and injure export-dependent workers and firms) by engendering high interest rates and raising the value of the U.S. dollar. Simon, for example, wrote in 1992 that the trade deficit would be cut 32 to 47 cents for every dollar reduction of the budget deficit (Simon 1992).

One solution to the problem of deficits might be to close the gap between outlays and revenues by simply raising taxes. However, there are three main arguments offered against this idea. First, raising taxes is highly unpopular because Americans feel they are already taxed too heavily and have little confidence in the public sector. Second, legislators are concerned about the disincentive effects of taxation -- and fear that higher taxes would have a negative impact on work, saving and investment (some worry this

disincentive might even cause some tax hikes to yield a net revenue loss). Finally, there is the view that higher taxes will simply pave the way for further spending increases. As Milton Friedman wrote in 1988:

Taxes have been going up for 50 years without any apparent success in eliminating deficits. That experience suggests Congress will spend whatever the tax system yields plus the highest deficit the public will accept (Friedman 1988).

Taking the "*public-choice*" perspective that government officials aim to serve their own interests, Friedman argues that the institutional reform of a constitutional amendment is required to link the self-interest of legislators to budget balancing. Today, Friedman maintains, a legislator has an incentive to act favorably on a lobbyist's request for public funds because gains are concentrated and highly visible while costs are small and widespread. A BBA, however, would alter this equation:

If a constitutional amendment required total spending to be limited, the legislator's self-interest would change. He could now tell the lobbyist, "You're right. Your project is excellent. However, the Constitution limits the total amount we can spend. I can only vote for your project if I vote less for something else. What else shall I vote less for?" That would pit one special interest against another and change the rules of the game in such a way that the legislator would now find it in his self-interest to operate in the public interest (Friedman 1986, 6).

The public-choice perspective just discussed also explains why deficit reduction has not been achieved through reductions in public expenditures: Congress has found it impossible to make substantial cuts. Thus, the BBA movement reflects a sense of

"desperation" that legislators feel over not being able to control deficits through political discipline. As Senator Pete Domenici (R-New Mexico) said in 1992, "We shouldn't have to do this. This is not the way to run the government, but we aren't running the government right now. ... It seems to be the only way" (quoted in Dewar and Gugliotta 1992, A14).

Additional arguments in the case for a BBA include the following:

- * We have no right to impose a debt burden of more than \$4 trillion on future generations -- a debt equal to more than \$19,000 per U.S. citizen. This concern is often raised as a matter of generational equity, constitutional liberty and morality (Peterson 1993). And, as our previous discussion of the nation's early aversion to debt suggests, it is a position with deep roots in American history. But even when focusing on just the post-World War II era, one still finds a long tradition of expressions of this sort. For example, in a 1957 address Senator Barry Goldwater (R-Arizona) asked: "Where is the finely drawn line between freedom and slavery when, under the present deficit, every baby born in this country has a \$1,675 first-mortgage tag hanging around its neck?" (quoted in Kimmel 1959, 299).

- * Nearly all state and local governments in the nation are required to balance their budget each year (Schmertz 1994, 51).

- * According to Senators Simon and Domenici, recessions can be managed under the BBA. As Simon stated in 1994, "Since 1962, we have passed 11 stimulus packages to deal with recessions. Every

one of those has passed by more than 60 votes. We can deal with this [through the BBA override provision]" (Simon 1994, S1832; Domenici 1994, S1830).

* A BBA is needed now not merely because there has not been a federal surplus since FY 1969 but because painful choices must be forced "sooner rather than later" (Simon 1992). Although the deficit has fallen since FY 1992, legislators warn that it is far from under control. "Just give it a couple of years," says Senator Domenici, referring to projections of rising deficits in the years ahead due to rising entitlement costs and interest payments on the federal debt (Domenici 1994, S1831; Feinstein 1994, S1831). Present estimates of the Office of Management and Budget and Congressional Budget Office (CBO) indicate steady deficit increases into the middle of the next decade -- and when baby boomers begin to retire in 2010 the fiscal picture is expected to "deteriorate significantly" (Wessel and Frisby 1994).

* Finally, BBA supporters argue that since legislators are sworn to uphold the Constitution, they would be obliged to meet the terms of this amendment. They argue that a BBA imposes mechanisms that Congress "will not be able to routinely waive or ignore" (House Republican Conference 1994b, 1).

Part 2. The Case Against the Balanced Budget Amendment

It is easy to comprehend the frustration Americans feel toward the federal budget. After watching an almost endless series of congressional efforts to grapple with budgets over the past decade, citizens now hear that despite recent deficit reductions the future

brings only more and more red ink. But while a desire for decisive action on the deficit issue is understandable, it will be shown that the BBA in the Republican Contract would bring only further injury to our political and economic systems.

Political Dangers

As mentioned earlier, BBA advocates argue that Congress has shown it is unwilling and incapable of controlling spending; that its members have a personal interest in unbalanced budgets; that only a constitutional crutch can alter incentives and force spending restraint; and that future deficits will get much worse if no amendment is ratified. But the fact is that if the public-choice view of today's political incentives is correct, a constitutional amendment can neither alter members' incentives nor force legislators to change their behavior in a meaningful way. Instead, it is likely to produce new budget gimmickry and additional public dissatisfaction with Congress.

Even long-time BBA advocate Senator Simon acknowledges that Americans should not expect "an ironclad guarantee" of fiscal discipline under a constitutional amendment: "The Constitution is no place for airtight procedural details that can withstand budgetary tricks a future Administration or Congress might dream up (Simon 1992)." Former CBO director Rudolph Penner takes this point to its logical conclusion:

If there is little political will to realize a goal, putting it in the Constitution will not help. Thus, a constitutional amendment requiring a balanced budget will work as well as the Prohibition amendment (Penner 1992).

Penner argues that the futility of using constitutions to balance budgets "is clear from the experience of state governments" (Penner 1992). He writes:

While 49 [states] have constitutional provisions or legislation requiring a balanced budgets, many routinely resort to outrageous accounting gimmicks to "balance" budgets, and many have created "off-budget" agencies (Penner 1992).

In congressional testimony presented during the 1994 BBA debate, S Jay Levy and Edward Regan of The Jerome Levy Economics Institute expressed a similar view (Levy and Regan 1994).

"No matter how tightly drawn," note Levy and Regan, state balanced-budget requirements "do not block elected officials from pushing their budgets into some form of a deficit when those officials want to spend money for government programs they believe their constituents need." Drawing on recent studies and Mr. Regan's own experience in New York State government, Levy and Regan explain that many states do incur deficits -- and "at least 10 have done so one or more times in 1990, 1991 and 1992." They also note that 42 states have separate capital budgets which are not required to be balanced, and 37 states may borrow for capital projects (Levy and Regan 1994, 2).

Perhaps even more significant is that states can "resort to dubious practices and outright financial gimmicks to achieve budget balance, without which many more states would have reported deficits." In particular, Levy and Regan indicate that states use the following:

off-budget accounts (states borrow from pools of money

outside the general fund or shift the financing of functions to those accounts);

time receipt and payment activities (states accelerate revenues such as tax collections; they also delay expenditures to localities, school districts and suppliers, and delay refunds to taxpayers and salary payments to employees);

- *pension funds* (contributions are reduced by forcing changes in actuarial assumptions);

credit markets (borrowing repeatedly against the same assets by refinancing them even after the original debt has been mostly repaid);

- *asset sales* (buildings and roads, for example, are sold or transferred, sometimes to another state agency, under a sale-leaseback scheme); and

deferred maintenance (routine infrastructure repairs are avoided until deteriorating conditions make a major reconstruction unavoidable).

They conclude:

The flaw of a BBA at the federal level is that it would encourage use of these activities. Beyond papering over an otherwise unbalanced budget, unnecessary borrowings and payment deferrals shift the costs of today's programs to tomorrow's taxpayers. This erodes accountability. Members of Congress grapple with this issue everyday, but a further loss of public faith in government officials would occur if the proposed amendment were to pass (Levy and Regan 1994, 2-4).

In addition to state experience, Penner points to congressional behavior under Gramm-Rudman for additional evidence that legislating a numerical goal for the deficit is undesirable.

He writes:

Gramm-Rudman produced forecasts that promised to achieve deficit goals when there was little hope of coming close to them. It spawned accounting gimmicks that seemed to make the deficit lower than it really was. Some gimmicks cost the taxpayers money. For example, people who borrowed from the Government when interest rates were high were allowed to repay the loans early without a prepayment penalty. This made the deficit appear lower, but the Government lost significant interest income (Penner 1992).

A related concern was expressed by *The New York Times* in a 1992 editorial. It noted that the BBA "invites evasion -- such as loading new entitlements onto the backs of state governments and employers" ("Unbalanced" 1992). This point was developed further by Henry Aaron of The Brookings Institution during Senate testimony on the BBA in 1994. Aaron's conclusion was that the amendment "would be a historic blunder" because it would produce "endless and subtle mischief." He added, "It would not reduce the proclivities of elected officials to promote their favorite public objectives. It would simply penalize two forms of doing so -- direct expenditures and taxation." Other devices mentioned by Aaron include use of loans (rather than direct expenditures), loan guarantees, state and local mandates, and regulations on the private sector. Congress has much experience with such devices already; Aaron is concerned that the BBA would encourage their further use -- "even when direct spending or taxes are demonstrably superior" (Aaron 1994).⁶

By encouraging imaginative accounting and evasion, a BBA would divert congressional attention from more meaningful efforts to resolve the real and growing budget challenges facing our nation. (These challenges include the need for a consensus on current fiscal-policy objectives and priorities, and the need for action to address future difficulties in the realms of health care and retirement benefits.)' Moreover, under the BBA legislators would not find addressing these matters any easier. We are therefore likely to see an even further erosion of public confidence in our

government -- especially if, as Aaron expects, partisan politics triggers a never-ending series of debates on the appropriateness of particular evasions. Unlike recent budget discussions, such future ones would not only harm the reputation of Congress, they would also demean our nation's Constitution (Aaron 1994; Penner 1992).

This section closes with a discussion of nine additional political dangers associated with the BBA. They are as follows:

(1) As investment banker Peter Peterson and the 1994 *Economic Report of the President* both emphasize, no BBA can cut "a single penny" **from** the federal deficit by itself. The amendment announces only an *intention* regarding action to be taken in the future -- a time when we would still be confronted by "all the hard choices that face us now" (*Economic Report* 1994, 39; Peterson 1993, 226-227). According to Herbert Stein of the American Enterprise Institute, BBA supporters do not understand the lessons of Gramm-Rudman:

The Gramm-Rudman Acts had serious defects, but they were steps towards learning how to do better. One of the lessons ... was that it is futile to set ceilings for the deficit or for total spending without prior agreement on the major lines of the policies by which conformity to those ceilings is to be implemented. That is a lesson that authors of BBAs have not learned (Stein 1994. 5-6).

Even worse is Peterson's fear that passing a BBA "might persuade us to think we have solved our problem and thus divert our attention" from the need to make these difficult choices (Peterson 1993, 227).

(2) A number of observers have expressed concern that, as the

Economic Report of the President put it, a 60-percent congressional super-majority to waive the balanced budget requirement "threatens to reinstall both gridlock and the tyranny of the minority" (*Economic Report* 1994, 39). Penner, for example, notes it might be very difficult to break an impasse "if a super-majority cannot be found to approve a deficit and a simple majority cannot be found to take the steps necessary for a balanced budget" (Penner 1992). Aaron adds that the BBA would "increase the power of a determined minority not just to restrict the scope of government but also to expand their favorite programs." In a recession, he explains,

A determined 40 percent of *either* house could force the majority to support any particular tax or spending change (increase or decrease) as a condition for supporting the waiver of the balanced budget requirements (Aaron 1994, 2).

Placing such power in the hands of determined minorities, he concludes, "is surely bad policy" (Aaron 1994, 2).

(3) Another problem with the BBA is that although a vote for it may provide today's legislators with a short-term political gain, it is a requirement not imposed upon themselves but on members of Congress in FY 2002 and beyond. While there is a sensible case to be made for allowing ratification time and for a slow adjustment to budget balance, some have nevertheless suggested that an element of hypocrisy still exists. As then-Congressman (now White House Chief of Staff) Leon Panetta stated during a congressional hearing in 1992, "There's a lot of hypocrisy around here. There are a lot of members who will never vote tough choices, but they'll vote for a BBA because they know they will

never have to make a balanced budget" (quoted in Dewar and Gugliotta 1992, A14). Indeed, Representative Gerald Solomon (R-New York) received merely 73 House votes last March for the only existing program with a line-by-line accounting of how to achieve a balanced budget by the beginning of the next decade (Rosenbaum 1994).

(4) The above discussion suggests that a balanced-budget requirement cannot alter a legislator's incentives enough to force more responsible fiscal-policy actions. But one can at least accept this proposal as worthy of constitutional consideration because it appears as an initiative designed to correct what is perceived to be a fundamental weakness in our existing political structure. The tax-limitation proposal, however, introduces a fiscal-policy bias with much less merit as a constitutional issue. Indeed, as The New **York Times** wrote of the idea in 1992, it is a proposal which invites the suspicion that the true objective of many BBA supporters is to "finish the assault on public spending that Ronald Reagan began" -- a goal that some powerful House Republicans have indeed identified as an overarching objective of their movement (though not necessarily the BBA itself) ("Unbalanced" 1992). Moreover, outside observers are not the only ones who feel the tax-limitation measure "raises grave questions" about responsible constitutional governance. In 1992, Simon indicated that he would vote against his own balanced-budget proposal if it was altered to require a three-fifths vote for tax increases (Dewar and Gugliotta 1992, A14).

(5) A question of responsible governance is also raised when the budget amendment is considered in the context of the entire CWA. The Contract calls for tax cuts that the CBO and House Republicans estimate will produce a loss of \$148 billion in revenues over five years. The Republicans also call for increased defense spending and a protection of Social Security benefits. This led the Concord Coalition, chaired by former Senators Warren Rudman and Paul Tsongas, to the following conclusion on both the House Contract and a similar "Agenda for the Republican Majority" issued by Senate Republicans: "Clearly deficit reduction is not a priority in these plans. These documents are about getting votes, not about balancing the budget" (Concord Coalition 1994, 1).

In response to concerns regarding revenue losses in a plan that calls for deficit elimination, some Republicans have been emphasizing the need for a "dynamic scoring" of the revenue impact of tax changes. While this scoring may be sensible in theory, it is already leading to abuses in practice. For example, forecasts by the National Center for Policy Analysis -- which *Investor's Business Daily* calls a "supply-side think tank" whose economists "have close ties" to Representative Richard Armey (R-Texas) -- claim the Contract's tax cuts will stimulate economic growth and raise \$623 billion in federal revenues over five years ("Perspective" 1994). As Paul Craig Roberts, a major figure in the 1980s supply-side revolution reminds us, "none" of that decade's supply-side measures "ever claimed that tax cuts would pay for themselves ." In fact, he writes that the Reagan Administration in

particular, "did not predict that the tax cuts would be self-financing. It predicted the exact opposite -- that every dollar of tax cut would lose a dollar of revenue" (Roberts 1991, 25-27).⁸ Claims of revenue gains due to greater economic growth are made even more fantastic when considered in light of the Federal Reserve's current view that the economy is already at its growth limit and needs to be restrained to prevent inflation.

(6) Critics of the BBA have also raised an important political question about its enforcement. As Senator Harry Reid (D-Nevada) indicated during the 1994 BBA debate, legal scholars are concerned that once the amendment takes effect any congressional failure to produce balanced budgets would lead to judicial involvement in fiscal policy (since the federal courts are responsible for interpreting and overseeing enforcement of the Constitution) (Reid 1994). To avoid this unattractive outcome, some legislators have tried to write a BBA that preempts court action.⁹ But then the problem is that the amendment becomes entirely symbolic. An amendment left to Congress to enforce has no teeth and cannot be expected to affect either the incentives or actions of federal legislators.

(7) Yet another argument against the BBA is that it flows from a questionable premise regarding our present deficits. The public-choice perspective has suggested that deficits are a result of legislators' efforts to pursue their own individual interests at the expense of the public interest. But empirical work on trade policy by Robert Baldwin, an economist sympathetic to public-choice

theory, indicates that self-interest is not enough to explain policy decisions -- "interpersonal effects and broad social concerns are also needed" (Baldwin 1985, 165). Although citizens respond in the affirmative when pollsters ask simply if deficits should be reduced, Stein has emphasized that an attempt to achieve deficit reduction confronts one with an array of both benefits and costs (Stein 1994). Thus, it is not at all clear that the deficits of the past decade have been incompatible with public desires.

(8) The BBA critique presented so far suggests that those who feel dissatisfied with the fiscal actions of public officials should engage not in an effort to alter the Constitution but rather in an effort to change contemporary policy actions through political activism. This could prove effective regardless of whether legislators act in the public interest or their own interest -- because it would exert pressure that could link both interests to a particular agenda. Of course, fiscal conservatives have become more politically active in recent years, and this activism is having an impact on the federal government. At this point, then, time and resources of deficit-reduction advocates would seem to be most effectively spent if directed toward developing and marketing a rational blueprint for achieving balanced budgets, instead of toward lobbying for BBA ratification.

(9) Finally, it must be observed that many have recently indicated the November 1994 elections represent a change in political direction that would make the BBA unnecessary. At a recent workshop of The Jerome Levy Economics Institute, for

example, Reagan emphasized that the 1994 election signaled the end of political rewards for "bringing home the pork." As Reagan explained, citizens have realized both that if the pork is being brought home to them it is being brought home to others too, and that it has become time to put an end to the entire feeding. This runs contrary to the public-choice view because it suggests political incentives were altered so that it is now clearly *in the self interest* of politicians to show fiscal restraint (Reagan 1994).

Economic Dangers

Turning to a discussion of economic problems with the BBA, one must first correct the CWA suggestion that an annually balanced budget would put Congress "under the same budget constraints as families and businesses" (CWA 1994). Businesses and households do not generally achieve -- or even strive for -- an overall budget balance each year. If families lived under the constraints proposed by the CWA, then individuals would need to pay cash for not only their automobiles but also for their houses and their children's college educations. If firms lived under this constraint, then enterprises could not resort to borrowing when investing in equipment or constructing new facilities -- and the almost universal private-sector practice of capital budgeting (taught in all corporate finance and accounting courses) would need to come to an end. In fact, few state, local and even national governments could live under this budget rule, for public-sector capital budgets are quite common both in this country and abroad.¹⁰

Moreover, a national government has a unique responsibility --

it alone is responsible for economic stabilization. Thus, even if legislators could avoid all the political dangers identified above, their prize would merely be achievement of the wrong economic goal.¹¹ In fact, maintaining an annually balanced budget would require tax increases and/or spending cuts in a recession -- actions that would *exacerbate*, rather than compensate for, the cyclical downturn. As Aaron has written:

One does not need to be a primitive Keynesian to believe that a requirement forcing tax increases or spending cuts during economic slowdown could be catastrophic. ... I can think of few policies better calculated to turn economic shocks into major calamities than a balanced budget requirement (Aaron 1994, 7).

There are also problems with Simon's suggestion that the balanced-budget requirement will be easy to waive in times of recession. The vote margin on successful, past stimulus packages does not ensure that legislators will be able to respond quickly and effectively to every fluctuation in our economy -- especially since, as any student of economics and government knows, there are many types of "lags" that slow the policy process. Moreover, the waiver suggestion ignores the fact that stimulus packages are not always needed today because various automatic stabilizers are an inherent part of our present tax and expenditure system. The BBA would require a Congress fearful of unanticipated deficits to consider *defusing* these valuable mechanisms.

In short, the BBA ignores the reality of modern fiscal constraints and points us in the wrong direction -- back to a less stable era of budget balance, not economic balance. In this

manner, it offers a toxin, not a tonic, for our economic ills.

Review

The BBA is only a statement of intention. Its passage does *not* substitute for the need to make difficult choices. Moreover, Gramm-Rudman and the experience of the states show the futility of adopting budget statements when there is no political will to carry them out. Even locating this statement in the Constitution offers no special advantage: amending that document offers *no* airtight protection against evasion. As Levy and Regan write, all fiscal straightjackets "*can be stretched*" (Levy and Regan 1994, 4). If legislators want a balanced budget, we will get one even without a BBA. If they don't, the BBA can only taint our Constitution -- and lead to more citizen frustration and a further loss of confidence in our political institutions.

Further, the BBA is, from an economic perspective, a very *misguided* statement of intention. It ignores the reality of private-sector budgeting, precludes the development of federal capital-budgeting procedures (procedures used effectively by governments in the U.S. and abroad), and hinders the public-sector's ability to compensate for cyclical fluctuations in the economy.

Part 3. An Alternative: Full-Employment Budgeting

If the BBA will bring only further injury to our political and economic systems, then how should our budget system be reformed? To begin, we must be clear on the problems we seek to resolve. Perhaps the primary problem is that fiscal policy appears to

citizens as unconstrained and directionless. Another is Americans feel both that the public sector is inefficient and that too few of today's federal expenditures represent an investment in our future well-being. A third concern is that our budget process seems never-ending. In fact, many have described the process as *continuous* budgeting -- a system in which "decisions are so frequent they are never final" (Rivlin 1986). Still another problem is that the projected growth of "entitlements," such as health-care costs and Social Security, threatens to overwhelm all other future fiscal concerns. The focus in most of what follows will, like the BBA, be on the first of these issues.

Recommendation: Balance the Structural Budget

Much support for the BBA seems to spring from a belief that U.S. fiscal policy is rudderless. But that amendment, as discussed above, is both wrong in principle (see "Economic Dangers") and destructive in practice (see "Political Dangers").¹² A more sensible alternative would be to seek a balance in our "high-employment," or *structural*, budget -- in other words, to pursue a policy of *full-employment budgeting*.¹³

A full-employment (yet another name is "cyclically-adjusted") budget is one designed so that a zero deficit, or some predetermined surplus, "would result if the economy were at a high-level of employment" (*Economic Report* 1994, 26). The approach yields a deficit -- to compensate for a shortfall of private spending -- in times of less than full employment.¹⁴ It also generates an increasing surplus as unemployment falls beyond the

"full-employment" level.

This approach allows legislators and the public to easily distinguish deficits caused by *cyclical* fluctuations from deficits that are due to more *structural* imbalances in receipts and expenditures (See Table 2). Further, an intention to eliminate structural deficits would be both more economically sound and politically achievable than the goal of an annually balanced budget. Another strength of full-employment budgeting is that while offering a budget rule that everyone can understand, it continues to emphasize the federal government's countercyclical responsibilities.¹⁵

TABLE 2.
STRUCTURAL BUDGET SURPLUS OR DEFICIT (-), 1959-98
[Unified structural budget averages; inflation-adjusted]

Fiscal Years	Percentage of GDP
1959-1982	0.1
1983-1993	- 1.9
1994-1998 (forecast)	- 0.8

Source: *Economic Report of the President*, February 1994.

But what is the appropriate unemployment target for full-employment budgeting? When the question was asked in the mid-1970s, a U.S. Bureau of Labor Statistics study estimated frictional unemployment at between 2.4 and 3.8 percent. This led Senator Hubert Humphrey to advocate a goal of 4 percent for the overall labor force, a goal enacted *into law* by the "Full Employment and Balanced Growth Act of 1978" (Humphrey 1976). Of course, some economists believe in a higher "natural" rate of unemployment -- a rate beyond which further increases in aggregate demand will be fully translated into inflation. But there is a growing body of theoretical and empirical evidence that challenges this notion (see, for example, Wolfson (1993) and Eisner (1994)). Moreover, adherents acknowledge that the natural rate can be shifted by institutional changes and structural economic developments -- there is even evidence to suggest the predominant economic trends since the early 1980s are ones that would cause this rate to *fall* (Rissman 1988). Consequently, legislators have no reason to scrap the employment goal that is already a part of the law of this land. Achieving the 4 percent goal without inflation may require more than traditional demand-management tools, but it is *not* impossible.

Other Recommendations

Both political parties recognize the public's desire for a more efficient public sector and are seeking to respond with initiatives that streamline federal structures, procedures and policies. President Clinton has also emphasized the need to bring a greater investment orientation to federal expenditures -- with

special attention to investments in human resources, infrastructure and technology. The bipartisan Competitiveness Policy Council suggests that Congress and the White House adopt an "Investment Budget" that allows consideration of the trade-off between public investment and consumption, and that contributes to development of a consensus on national fiscal goals and priorities (Competitiveness Policy Council 1993, 8). This type of budgeting is essential in our present era of global competition, worker insecurity, and "man-made" comparative advantage. (In fact, I would recommend linking this reform to the full-employment budget by requiring each year's public investments to be at least equal to the size of our compensatory expenditures. This would ensure that borrowing does not finance current consumption.)

Another budget reform worth consideration is a two-year budget and appropriations cycle. A BBA still requires the budget to be revisited each year; biennial budgets do not. This reform could ease the frustrations engendered by continuous budgeting; allow legislators more time for program reviews and evaluations; and -- even with provisions enabling changes in emergencies -- promote economic stability. It might also make a small contribution to the goal of deficit reduction by providing less opportunity for modification of multi-year agreements and by allowing the gradual imposition of fiscal changes. While a two-year cycle has been one of the most widely discussed budget-process reforms of the past decade, Washington's new bipartisan attention to streamlining government suggests the present may be the perfect time to adopt

this reform.¹⁶

Finally, there is the problem of the expected explosive growth in entitlements. Although the chairmen of Congress's Bipartisan Commission on Entitlement and Tax Reform (BCETR) were unable to win support for specific proposals in **1994**, Budget Director Alice Rivlin has correctly observed that the commission played "an extremely useful role" by "focusing attention on the big problems of the next century" (quoted in Pear).¹⁷ To make future progress in this realm, we need two panels with narrower agendas than the BCETR -- one to address health-care policy and another to focus on ensuring the viability of Social Security. These are the specific policy areas where we can anticipate our most significant future problems. As the Economic Policy Institute's Max Sawicky suggests, work in both areas must be guided by two principles: support for the missions of existing programs, and commitment to reform that is structural, not merely fiscal (such as imposition of expenditure caps) (Sawicky **1994**, 1-2).¹⁸

Conclusion

The first item in the Republican legislative agenda for the 104th Congress is a BBA offered under the title "The Fiscal Responsibility Act." But this proposal would produce only more fiscal irresponsibility. It is founded on a misdirected and dangerous economic principle, and is likely to bring harm to the political system once put into practice. A much more sensible alternative is already suggested by the **1978** Full Employment and Balanced Growth Act, a law requiring the President and Congress to

adopt an economic strategy that achieves and maintains a 4 percent unemployment rate for the labor force. Instead of working to enact the BBA, legislators and citizens should seek compliance with our present law -- compliance that can be best pursued by an emphasis on *full-employment budgeting*.

Other reform initiatives may also be worth consideration, including investment and biennial budgeting, and a new bipartisan effort to tackle the problem of entitlement spending. But the foundation of a fiscally-responsible, budget-reform program must be to achieve and maintain full employment by balancing the *structural* budget, not the annual budget. Any Constitutional amendment regarding budget balance is a bad idea for reasons that have been outlined above; but if the new Congress *insists* on a BBA, they should at least shift their focus to the high-employment budget.

Notes

1. Federal expenditures were about 18 percent of gross domestic product (GDP) in the second half of the 1950s. The figure was 10.8 percent in 1934 and has been about 23 percent in the 1990s (*Economic Report of the President* 1994, 362).
2. The legislation failed by one vote in the Senate in 1986, and by seven votes in the House in 1990.
3. The unified federal deficit for Fiscal Year (FY) 1992 was \$290.4 billion, and when one excludes off-budget receipts and outlays (including the Social Security surplus) that number rises to \$340.5 billion. According to *The Washington Post*, initial 1992 forecasts for FY 1993 predicted a deficit of over \$400 billion (Dewar and Gugliotta 1992, A14).
4. During the 1992 debate, over 400 economists -- including seven Nobel Prize recipients -- released a statement opposing the amendment. See "Economists Oppose BBA" (1992).
5. On the matter of budget execution, this proposal states that "Congress and the President shall ensure that actual outlays do not exceed the outlays set forth" in the budget; it also states,

"Congress shall enforce and implement this Article by appropriate legislation." (House Republican Conference 1994a, Z-3).

6. For a recent discussion of the present widespread use of one of these devices -- the federal mandate -- see Lashutka (1994). Similarly, members of the Republican Governors Association, meeting only days after the November 1994 election, warned that they did not want the federal budget to be cut at the expense of the states. As Richard Berke reported in *The New York Times*:

They [the governors] took care not to directly attack Mr. Gingrich [the incoming House Speaker] and some even embraced his call for a balanced budget amendment, *but only on the condition that such an amendment would include language barring the Federal Government from passing on the increased financial burden to the states* (Berke 1994, emphasis added).

The CWA amendment offers no such language -- and it is not obvious that a meaningful and enforceable provision of this sort could indeed be written.

7. According to Michael Hurd, an expert on the economics of aging, health-care costs in 2020 will rise to between 23 and 36 percent of GDP, while the number of retirees per 100 workers is expected to rise from today's 30 to between 41 and 67 by 2040 ("The Economics of Aging" 1994, 2). The present rate of growth in Medicare and Medicaid expenditures is 15 percent per year.

8. Roberts adds, "Moreover, as far as I can ascertain, no supply-side economist inside or outside the Reagan Administration ever said that tax cuts would pay for themselves" (Roberts 1991, 26).

9. Court involvement is unattractive for many reasons, including the following: the courts operate in a manner that is too slow to allow timely action on disputes over budgets and fiscal policy; judges have no special expertise in budget matters; and the Constitution's framers sought to exclude the judiciary from fiscal decisions. For more on the problems of judicial enforcement, see Bork (1990).

10. As mentioned earlier, 42 states have capital budgets (Levy and Regan 1994, 2).

11. It has been argued, for example, that a balanced federal budget in 1993 would have cut that year's business profits almost in half (Levy 1994, 2). A study by Wharton Econometric Forecasting Associates, meanwhile, finds that moving the federal budget incrementally into balance by the year 2003 would cost the private sector almost 6.5 million jobs (Karl and Bachman 1994).

12. See "Unbalanced" (1992) for a similar distinction between "wrong in principle and destructive in practice."

13. The suggestion that federal officials focus on the high-employment budget is not new. It was mentioned, for example, by Northern Telecom's Chairman and CEO, Edmund B. Fitzgerald, in 1988 during a BBA hearing before the U.S. House Committee on the Judiciary. Fitzgerald appeared before the committee on behalf of the trustees of the Committee for Economic Development, a group for which he served as Chairman at the time (Fitzgerald 1988).

14. In periods of cyclical unemployment, deficits of the size required to compensate for private-sector slackness do not threaten to "crowd out" business investment. Even BBA adherents recognize this, as Simon's discussion of the BBA waiver indicates above. Further, empirical work by Robert Eisner on the U.S. economy since the early 1960s shows that higher deficits have been associated with more rapid subsequent growth in real product -- and with less subsequent unemployment (Eisner 1994, 106-109). In short, the economic impact of a deficit depends in large part on the state of the economy.

Similarly, the impact of a federal deficit depends partly on the nature of public expenditures. As Stein noted in his 1994 BBA testimony, we do not have to apologize for our debt legacy if borrowing is for investments that leave a safer world and a more prosperous economy for our children and grandchildren (Stein 1994). (Supporting this position is work by Sharon J. Erenburg (1994) and other economists who have recently produced much evidence that suggests public infrastructure spending has a positive effect on private sector equipment investment, productivity, and real wages.) Borrowing that finances only current consumption, however, is much less defensible.

15. Since an argument in the case for the BBA was that deficits hurt our trade position, we should note there is no clear relationship between trade and budget deficits. Since 1992, in fact, our trade balance has worsened while the federal deficit has fallen. (For a good effort to disentangle these "twin deficits," see Blecker (1992) .) In short, trade concerns should not deter federal officials from fulfilling their countercyclical responsibilities.

16. For more on biennial budgeting, see Whalen (1994).

17. The entitlements commission was headed by Senator Bob Kerry (D-Nebraska) and Representative John Danforth (R-Missouri).

18. The 1983 panel convened to address imminent problems in the financing of Social Security demonstrates that a bipartisan effort focused on problems in a single policy area can indeed be effective.

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