POLICY REPORT

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# Carter Economics and Reagan Economics: A Market Analysis

by Barry P. Brownstein

There are those who maintain that the difference between Democrats and Republicans is the difference between two distinct economic viewpoints, yet on close examination the difference is less than striking. As the 1980 election approaches, both the federal budget and deficit continue to expand: The fiscal 1980 deficit is already near $60 billion and certain to increase. Inflation goes unchecked and productivity continues to drop. But neither Carter nor Reagan offers any genuine solutions to these problems, and certainly neither represents anything approaching advocacy of a truly free-market economy.

During his 1976 campaign, Carter railed against the 4.8% inflation rate and 7.9% unemployment rate. He promised a balanced budget and a reorganization of government. What he has given us, however, is an inflation rate nearly three times that of 1976 (a rate that he recently had the temerity to insist has "fallen sharply"), an increasing deficit, and two new executive departments, education and energy.

Next year federal taxes are scheduled to rise by $108 billion because of planned increases in social security taxes, a windfall profits tax, and inflation-induced higher tax brackets. The toll in reduced productivity, reduced incentives, and misallocated resources can scarcely be calculated, yet neither Carter's nor Reagan's tax proposals offer any real relief.

Carter and the Democrats will not provide any real tax relief this year, arguing that to do so would be "irresponsible." Instead they promise more spending, including a $12 billion jobs program. Although the Carter administration has proposed a $27.6 billion "tax cut" for 1981, this cut doesn't cover the planned increase in social security taxes, let alone compensate for the increase in taxes due to "bracket creep." Even if the Carter proposal is enacted, the tax burden will still rise by about $80 billion.

**"Recently Reagan has become evasive about his promise to make tax cuts and has begun to hedge on the platform plank against budget deficits."**

Reagan has given some much-publicized support to the Kemp-Roth bill (H.R. 13769) to reduce individual income tax rates by 30% over the next three years, but Kemp-Roth will in fact do little to reduce the tax burden. If enacted, this bill will reduce taxes only by about $36 billion. In addition, Reagan and the Republicans have refused to specify substantial spending cuts. Instead, their platform promises new defense spending, higher farm support prices, and subsidized energy research. Rather than reduce spending, the Republicans prefer to gamble on the possibility that the economy is on that portion of the Laffer Curve where a reduction in tax rates will result in increased revenues to the government. Although there is little doubt that a tax cut will cause an increase in taxable income because it will increase the incentive to produce, it is doubtful that there will be an actual increase in revenues. The question of what consequences a slight reduction in the scheduled rate of tax increases will have is an empirical one.

Recently Reagan has become evasive about his promise to make even these modest tax cuts and has begun to hedge on the platform plank against budget deficits. Reports are that he is under pressure from some of his advisers to phase in Kemp-Roth over a longer period of time than three years. In addition, a new Reagan economic plan is said to be in the works that concludes that government spending cannot be cut fast enough to eliminate budget deficits for at least three more years. Thus it is clear that neither Reagan nor Carter will balance the budget as quickly as it could be done.

A major result of the deficit will be continued inflation. If we define inflation as an increase in the amount of currency and coin in circulation, it becomes clear that higher oil prices, higher food prices, higher wages, etc., are not a cause of inflation but a result of it. It is not surprising that inflation is blamed on incorrect causes. One study of the media's treatment of inflation notes that in only 12 out of 200 stories dealing with inflation on the "CBS Evening News" during 1978 and 1979 was "there so much as a hint of a monetary role in inflation."[1]

By increasing the money supply, the government extends its command over

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*EDITORIAL*

# Tax Cuts: Myth or Reality?

Nothing is more popular at election time than promises from candidates to balance budgets and lower income taxes. Yet this presidential election year is unique because of the ascendance of "supply-side" economic analysis and the by now virtually unanimous support tax cuts enjoy across the political spectrum. The "tax revolt" has indeed arrived in Washington. What are the likely results?

No major candidate is proposing a tax cut in the same sense that American voters understand the term, that is, as an actual reduction in their taxes. At most, Carter and Reagan are offering a decrease in the rate of tax increase as a substitute for tax relief. In his discussion of Carter's projected 1981 budget (*Newsweek*, 24 March 1980), Milton Friedman pointed this out most succinctly:

> Compare the proposed $14 billion "cut" for fiscal 1981 with the $38 billion upward revision in projected spending for that year, or with the $52 billion increase in projected spending from fiscal 1980 to 1981. President Carter has not proposed a meaningful cut in spending. He has simply proposed a slightly smaller *increase*. We should be considering cuts of $60 billion to $100 billion in fiscal 1981 projected spending, not $14 billion.

The combination of government monetary policy and institutionalized increases in such taxes as social security regularly raises the taxes of all Americans, whether or not their incomes increase. To be meaningful, a tax cut must overcome these automatic increases and actually *decrease* the financial burden borne by beleaguered taxpayers. It may be true that eventually all the desired effects implied by Laffer-curve analysis will materialize: higher productivity, lower taxes, and higher tax revenues. But these are questions of efficiency rather than equity, and further, they are empirical in nature and can be answered only after a major tax cut takes place.

While it would be beneficial to have an answer to the "supply-side" debate (see *Policy Report*, August 1980), it would be even better to have reduced taxes *on principle*. This is not a time for merely cosmetic decreases in the rate of tax increases; it is a time for large, across-the-board reductions in the magnitude of government at all levels of society. If the government continues to withhold tax relief, the result will be more widespread tax cheating, large increases in the underground economy, and vast bonanzas for attorneys and tax consultants.

Consider the evidence:

| Federal Outlays (in billions) | | | |
|---|---|---|---|
| 1960 | 92.2 | 1975 | 326.1 |
| 1965 | 118.5 | 1980 | 564.0 |
| 1970 | 196.6 | *1985 | 903.0 |

*Projected

Add to these totals state and local government expenditures (which took ten years to double between 1960 and 1970 but now more than double every five years) along with total federal debt (which finances yearly deficits and off-budget expenditures) and some indication of the vastness of the present tax burden becomes clear. If present trends continue through 1985, with continued inflation, low productivity growth, and continued government expansion, a tax burden of well over $1.5 trillion and a national debt well in excess of $1 trillion dollars will be our heritage. The deleterious effects of such a scenario on productivity, product quality, and the social fabric can only be guessed at, but few observers can be optimistic.

There comes a time when no further studies are needed on declining productivity, wasted paperwork, bureaucratic growth, overpaid government employees, or magic ways to increase revenues and decrease taxes. It is a time when wishes and hopes and even what may be "politically impossible," must give way to necessity. That time is now, and that necessity is massive tax cutting. No other sane option is open, no matter who wins the presidency. ■

## Carter and Reagan (Cont. from p. 1)

resources without having to increase taxes. The Federal Reserve Board, in cooperation with the banking system, buys part of the government-issued debt in order to prevent government borrowing from drastically increasing interest rates (thus crowding out much private borrowing). By buying bonds—a procedure called "open market operations"—the Federal Reserve Board injects reserves into the banking system, thus creating inflation and lowering interest rates. With the Treasury prepared to market a record level of new debt in the coming 18 months, the prospects for holding down interest rates and inflation are hardly encouraging.

Inflation not only raises the general price level but also changes relative prices. The interest rate acts as a market signal that helps allocate goods between higher order (capital) and lower order (consumer) goods. The lowering of the interest rate to a level below where it would be in the absence of monetary expansion distorts this important market signal. When interest rates fall as a result of expansionary monetary policy (and not as a result of



an increase in voluntary savings on the part of consumers), businesses react by increasing their amount of capital goods expenditures, but this increased investment is malinvestment because it is the result of a distorted market signal. When correct market information becomes available, the malinvestment must be liquidated, and the result is unemployment. The unemployment would be temporary were it not for the government's desire to increase its share of resources and stop the market from dissolving the malinvestment. The inevitable bust can be postponed only temporarily, and the longer the inflationary period, the longer and more widespread the resulting period of unemployment.

Both Reagan's and Carter's tax and budgetary proposals indicate that they are not prepared to allow the marketplace the period of adjustment it needs. In addition, they have proposed disastrous energy, trade, and corporate bailout policies that can only hinder the process of adjustment.

**Free Trade**

Virtually all economists support free international trade, yet the platforms of the Democrats and Republicans and the actions of Carter and Reagan suggest little commitment to this goal: The political appeal of protectionism is too great to resist.

The Republican platform declares that Republicans will "not stand idly by as the jobs of millions of Americans are lost" in the automobile, textile, and steel industries. The Republicans promise to consider "appropriate measures necessary to insure fair and equal competition." In a speech he made in Michigan in early September, Reagan made it clear that he does not understand the concept of free trade, which is one of the basic principles underlying the free market. Speaking to Chrysler workers on 2 September, Reagan vowed to convince the Japanese "one way or another" to "slow the deluge of cars into the United States." Later that day, lunching with Lee Iacocca, the president of the Chrysler Corporation, Reagan promised that if the "deluge" of imported cars continued when he became president, he would move to protect the domestic automobile industry.

The Democrats advocate similar policies in their platform, calling upon "the Government to take swift, effective anti-dumping actions and enforce all U.S. trade laws to assure an end to unfair trade practices that lead to the export of American jobs." Carter, along with others in his administration such as Secretary of Transportation Neil E. Goldschmidt, has made it clear that he values the backing of the auto, steel, and rubber industries and their powerful unions more than the standard of living of the bulk of the American people. For instance, in a recent ruling that may eventually cost the jobs of 10,000 Toyota workers in Los Angeles who assemble trucks, the Carter administration has increased the duty on partially assembled Japanese trucks from 4% to 25%. Carter has also asked the International Trade Commission to speed up the release of its findings about the possible "damage" that imports do to the U.S. auto industry so they will be available before election day. His request was denied.

These policies illustrate well why government grows. The benefits of a protective tariff are concentrated: The automakers and the workers reap the bulk of the gains and the costs are distributed among consumers. The automobile industry has a stronger incentive to promote a tariff than the rest of us have to oppose it, even though what is in the best interests of the automobile industry is not necessarily in the best interests of the rest of us.

An attempt to protect the apple growers of New York State from "unfair competition" from apple growers in Washington would be immediately recognized for what it is: a naked attempt to increase the income of the apple growers of New York at the expense of apple consumers, yet similar

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*In This Issue*




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## Carter and Reagan (Cont. from p. 3)

sophistry from advocates of import curbs on steel, textiles, and automobiles finds a wide and sympathetic audience. The effect of such import curbs is clear: The producers and workers in those industries enjoy a higher income at the expense of all other consumers.

In a free market resources are employed according to their highest-valued use. A major result of a protective tariff or import quota, however, is that resources are diverted from the use to which they are best suited because subsidization in the form of a tariff makes an industry seem more lucrative than it actually is. Resources flow out of areas where they should be—as determined by the market signals of prices and profits—and into areas where they should not be.

The automobile, textile, and steel industries, among others, would probably shrink in relative size without protection from foreign competition. However, tariffs, along with aid to "displaced workers" (which both Democrats and Republicans support) will stop this process of adjustment from taking place, and expanding areas of the economy will be denied the capital they need to flourish.

The Carter administration has lobbied for additional policies to subsidize inefficient industries at the expense of healthy ones. Proposals include $2.4 billion in subsidies to firms that do not even pay taxes as well as $3 billion in direct loans and loan guarantees to encourage investment in distressed areas. Reagan has reversed himself and now supports loan guarantees to Chrysler, and one may therefore reasonably expect him to advocate similar policies if he is elected president. Carter has also proposed the establishment of an Economic Revitalization Board made up of government, industry, and labor representatives. What one can expect from such a board is summed up by the *Wall Street Journal*:

> Will this committee come up with a lot of new ideas for restoring competition and efficiency? Or will it come up with ideas for protecting existing corporations, labor unions and government bureaus from threats to their present security? Give yourself a correct score if you choose answer number two.[2]

**"The Carter administration has already given us a disastrous combination of a windfall profits tax, price controls, a Department of Energy, and a Synthetic Fuels Corporation."**

### Energy

So much has been made of proposed government solutions to the energy crisis that one can easily lose track of the fact that the energy crisis is *caused* by the government. Not surprisingly, the Republicans and Democrats have also lost track of this fact.

The Carter administration has already given us a disastrous combination of a windfall profits tax, price controls, a Department of Energy, and a Synthetic Fuels Corporation. More is promised. The Democratic platform calls for government support for hydrogen cars, solar energy, biomass, fusion, and gasahol energies, "tough compliance with energy price laws," standby gas rationing, support for the coal industry, and mandatory energy performance standards.

In some respects the Republican platform is remarkably similar to the Democrats'. The Republicans call for government development and research programs in coal, solar, gasahol, biomass, wind, and fusion energies. Any lingering doubts that one may have about the Republicans' lack of commitment to the free market are shattered when one learns that they support immediate repeal of the windfall profits tax ... but only for "new oil."

Profits are both an economic signal that helps allocate scarce resources to their highest-valued use and a reward for entrepreneurial risk taking. An understanding of the economic role of profits underscores the political nature of the windfall profits tax. The severing of the link between production and monetary rewards destroys incentives to locate more oil. Tom Bethell points out that

> until we can perceive that the independent driller whose goal in life is to become a millionaire works to our advantage more effectively than the selfless "consumer advocate" in Washington, whose true goal surely is the attainment of personal power (even if he does call it "fairness") then we will always have an energy crisis on our hands.[3]

It is no coincidence that products whose production or distribution has been affected by government intervention are the only ones of which we experience shortages. Only a price system operating through the free market can coordinate the activities of millions of individuals. A shortage in a free market will exist only temporarily because the excess demand will act as a signal to suppliers to increase their asking price. This higher price will increase the relative price of the good in question, causing a reduction in quantity demanded and an increase in the quantity supplied.

The strength of the price system is that the information required to coordinate a market need not be in the hands of a central planner.[4] When the price of oil rises, the consumer of oil need not know *why* the price has risen; the higher price simply tells him he must conserve. Depending on the strength of his demand for oil, he may cut his demand only slightly or cut it greatly by switching to an oil substitute. Only the consumer of oil can have the relevant information about how much he must have and what alternatives are available to him.



Contrast a freely operating price system with a government board allocating the oil. The board tries to determine who can get by with less oil, but because each user of oil insists that there is no substitute for oil in his manufacturing process, the oil board has no choice but to allocate oil either on the basis of an arbitrary rule—such as a 10% cut for all users—or on a political basis.

In a dynamic world the task of fairly allocating oil would appear to be insurmountable. Will a new product be able to get the oil it needs? Suppose this new product is a hand-held calculator that the bureaucrats serving on the board have never heard of. What would the result be then? In a free market each resource goes to its highest-valued use, and thus if the producer of the calculator expects to earn profits through the manufacture of his product, he will be able to outbid other users for his share of the scarce resource.

### Farm Policy

Although professing to be inflation fighters, both the Democrats and the Republicans will see to it that the American consumer continues to pay higher prices for food than those a free market would provide. Because of a combination of parity price supports, loans, subsidies, and acreage restrictions, the public pays higher prices for food and, in addition, pays taxes to buy up surplus products and to fund the Department of Agriculture, which administers the whole mess.

Under the Carter administration we have seen such spectacles as milk price supports being raised just prior to the Wisconsin primary. The Democrats promise more of the same, promising "to increase the level of support for farm prices." On this issue the Republicans are no different, supporting farm programs with the goal of surpassing parity.

### Minimum Wage

One of the major causes of unemployment in the United States,

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## Briefs

☐ *The Political Economy of Federal Government Growth: 1959–1978*, a recent book by James Bennett and Manuel Johnson of George Mason University, investigates the nature and causes of the expansion of the federal sector in the past two decades. The book's basic thesis is that all earlier studies have grossly understated the size of the federal government because they have ignored qualitative changes in employment and expenditures. The composition of employees has shifted from blue- to white-collar workers, white-collar workers have shifted to administrative grades, the use of contractors and consultants has increased dramatically, and tens of thousands of part-time employees are not counted in the reported statistics. On the expenditure side, the authors argue that the costs of regulation and paperwork must be included and future financial liabilities taken into account to measure accurately the growth of government. Various explanations of the cause of growth are critically examined and an alternative is proposed: Government grows because those in government benefit from growth. The authors develop policy prescriptions for reducing the size of government.

☐ "If at first you don't succeed, try, try again" is the motto of Citizens for a Better Environment (CBE). In 1979 CBE asked the Environmental Protection Agency to ban sludge fertilizers on the grounds that they are a public health hazard, but the EPA's response was only an advisory warning about the product. Unhappy with this approach, the CBE went to the Consumer Product Safety Commission, again demanding an outright ban on these fertilizers. Again, the answer was no. Undaunted, the CBE is continuing its fight through both state and local governments, as well as the courts.

☐ Federal, state, and local taxes have risen 155% over the last ten years—twice as fast as the rate of inflation. As a result, Americans are now paying more in taxes than they are spending on necessities. In 1978, for instance, they paid $624.3 billion in taxes and $575.1 billion for necessities (food, clothing, housing). The government reaps additional gains when inflation pushes taxpayers into higher tax brackets. It is estimated that the federal government will collect $33 billion over the next two years because of the so-called bracket effect.

☐ Because of equipment failures, overcrowded and overheated cars, and late trains, many Conrail passengers who commute to New York City are refusing to pay their fares and urging other riders to do the same. A quick look at the facts shows the customers' complaints are justified. Although the number of riders has increased 25% since 1976, no new cars have been added. In July the trains were late over 22% of the time on the New York Central lines. Not only does Conrail provide shoddy service, it lost $178 million in 1979, all of it at taxpayers' expense.

☐ Only ten years ago a law firm was considered a giant if it employed over 100 lawyers. Today twenty corporations have legal departments of 100 lawyers or more, with AT&T leading the pack with 902 lawyers. Runners-up are Exxon and General Electric with 384 and 302 lawyers, respectively. A spokesman for General Electric attributed the increase in lawyers to government litigation in the areas of antitrust, product liability, discrimination suits, and environmental law.

☐ In 1980 Tax Freedom Day (the day on which an average worker's taxes would be paid if all his earnings from January 1 onward were used to pay his taxes) was May 11. At the current rate of increase in taxes, Americans will be working the entire year for the IRS in less than two hundred years. ■

## Carter and Reagan

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especially among teenagers, is the minimum wage law. The great bulk of us, whose wages are determined by the supply of and the demand for our services, earn more than the minimum wage. Although an employer might very well like to pay his employees 8¢ an hour, it is the worker's productivity that prevents him from doing so, not the minimum wage law. However, the minimum wage law does have one important effect: It prevents the hiring of those workers whose value to the potential employer is below the minimum wage. Thus the minimum wage hurts those with the fewest skills, such as minority teenagers. In 1948 unemployment among black youths was 9.4%, but today it runs nearly 50% in some areas. Surely the blame must be placed on a law that prohibits minority youth from being hired at below the minimum wage.

The minimum wage in effect prohibits voluntary exchange, which, ex ante, must benefit both parties or the exchange would not take place. The prohibition of voluntary exchange interferes with specialization, to the detriment of the entire economy. The weight of the law, however, falls heaviest on those who are prevented from working and who thus may be being denied the opportunity of learning a skill.

If the poor are not the beneficiaries of the legislation, then one may ask who is. One need look no farther than the principal backers of the legislation, the labor unions. An increase in the price of unskilled labor causes the relative price of skilled labor to fall. If the price of margarine rises, consumers will buy more butter. Similarly, an increase in the minimum wage causes an increase in the demand for skilled labor, which translates into higher salaries for skilled labor.

Welfare bureaucrats also generally support increases in the minimum wage. Their support is not surprising because those who have made a career out of "helping" others always find more poverty to eradicate each time the minimum wage is increased.

Because labor is among their biggest backers, the Democrats strongly oppose any weakening in the minimum wage and continue to take a strong stand against a sub-minimum wage for youth. The Republicans, although they refuse to call for the abolition of the minimum wage, do at least call for a teenage wage differential.

The irony of the Democratic platform is not easily overlooked. The platform declares that its highest priority is to "guarantee a job for every American who is able to work," yet the rest of the platform would only destroy jobs if it were implemented. Higher taxes, higher farm prices, more energy intervention, and protectionism can only continue to slowly strangle the economy.

The Republican platform, although couched in a certain amount of free-market rhetoric, advocates many of the same interventionist policies as the Democratic platform. The Republicans can only give the free market an undeserved bad name. ■

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[1] Tom Bethell, "TV, Inflation and Government Handouts," *Wall Street Journal*, 8 July 1980, p. 12.

[2] Editorial, *Wall Street Journal*, 29 August 1980, p. 12.

[3] Tom Bethell, "The Gas Price Fixers," *Harpers*, June 1979, p. 105.

[4] For further discussion see F. A. Hayek, "The Use of Knowledge in Society," *American Economic Review* (September 1945), pp. 519–30.

# America's Reindustrialization: Corporatism Once Again

by John Battalana

There's a certain déjà vu quality about the media coverage of the Carter administration's latest proposals for a new economic policy. Not that there isn't something real that elicits the call to meet the "productivity crisis"; it's just that the gnawing suspicion that we've been through all this before won't go away. The government's most recent policy outlines are just the latest expressions of the many philosophic and economic errors that have existed in a host of countries since the Industrial Revolution.

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> **"A government-managed economy has found its clearest expression in the Keynesian policy prescriptions of the past four decades."**

World War I fostered certain doctrinal tendencies and institutional arrangements that have been described as manifestations of "corporatism." In Italy, Spain, Portugal, Brazil, and Austria (and later, France and Germany), the corporative state supplanted liberal, democratic political institutions. As the marketplaces of the West became increasingly politicized, private bodies claiming to represent the group interests of labor, of employers, of farmers, of consumers, of particular branches of industries, and of sundry economic and social groups became more integrated in order to increase their influence on governmental policies. As Ralph Bowen points out in his *German Theories of the Corporative State*,



these groups "...were given a degree of official recognition when they were allowed representation in National Economic Councils created to serve as advisory 'parliaments of industry.'"[1]

Economic crisis conditions provide a fertile seedbed for the growth of the corporate state. In 1932 the Reconstruction Finance Corporation, established by President Herbert Hoover, provided billions of dollars in loans and loan guarantees to help troubled banks and industries. In 1933 the Roosevelt administration created the National Recovery Administration (NRA), an agency assuming a host of initiatives and responsibilities previously fulfilled by the spontaneous interactions of the marketplace. It was no surprise that the growth of these and other agencies was accompanied by a willingness on the part of representatives of government, business, and labor to see that the array of executive and supervisory functions assumed by Washington, D.C., would operate to the advantage of the most influential of these competing interest groups. What all this has meant for the economy since World War I has been felicitously summarized by Murray N. Rothbard, who writes that "...the economy could be cartelized under the aegis of government... in the classic pattern of monopoly.... Labor, which had been becoming increasingly rambunctious, could be tamed and bridled into the service of this new, state monopoly-capitalis order through the device of promoting a suitably cooperative trade unionism and by bringing the willing union leaders into the planning system as junior partners."[2]

A government-managed economy has found its clearest expression in the Keynesian policy prescriptions of the past four decades. The public was to accept the fact that government intervention was a necessity in a free-market economy of fitful shifts of over- and underspending. Macroeconomics was enlisted to fine-tune the economy with the ultimate objective of

(Cont. on p. 8)

## Trade Regulations/Department of Education Watch

It is anticipated that $85 million will become available in new funds for the Department of Education to loan to campus housing programs. This program is being taken over from HUD, whose original purpose was to use the loans to bolster "historically black" colleges. Presumably those black colleges that integrate will lose their preferred status.

The Department of Education has ruled that grants to local educational agencies may be used only to purchase instructional materials. After what the Federal Register described as a "controversial debate," the department decided to include musical instruments but exclude physical education equipment from the category of instructional materials.

New regulations have been issued specifying that any individual or agency receiving federal assistance through the Department of Education must comply with any relevant federal energy regulations designed to conserve petroleum and natural gas. Most of these regulations are outlined in President Carter's Powerplant and Industrial Fuel Use Act of 1978.

The research grants program for the study of "organizational processes" in elementary and secondary schools has recently been broadened in an attempt to cover more schools. The program has already handed out over 60 grants, the smallest of which were in the $7,500 to $15,000 range.

Regulations have been issued for the Territorial Teacher Training Assistance Program, part of a 1978 act designed to provide assistance in teacher training to Guam, American Samoa, the Virgin Islands, the Mariana Islands, and the Trust Territory of the Pacific Islands. Although the program was previously run without any detailed regulations, it will now fall under the watchful eye of the Department of Education. The new regulations clarify such matters as whether one must teach children (as opposed to adults) to qualify as a teacher (no) and whether the phrase "nonindigenous contract teacher" excludes residents of the native islands (yes).

The Department of Education has announced the formation of the National Advisory Council on Indian Education, headed by Dr. Michael P. Doss. According to the Indian Education Act, which created the council, the major function of the council is to search for Department of Education programs that Indian children may be eligible for.

New regulations issued by the Department of Education insist that any institutions participating in the National Direct Student Loan, College Work-Study, Supplemental Educational Opportunity Grant, Guaranteed Student Loan, or Basic Educational Opportunity Grant programs must comply with the department's regulations concerning fiscal and accounting systems, biennial audits, and record retention. Furthermore, all of the institution's program and fiscal records must be made available to the secretary of education on demand.

The Basic Educational Opportunity Grant Program has amended its regulations to cover more students. The new regulations will allow a student who was formerly ineligible for grants because of his income to receive a grant if he can show he is from a low-income family.

# ✓ Washington Update

✓ The House of Representatives passed a bill that extends the government's housing programs for another three years. The bill authorizes $38 billion over the next 30 years to help people pay housing costs and continue traditional programs to help community development, insure mortgages, and provide rent subsidies.

✓ The Labor Department has expanded its unemployment benefits program in order to cover workers when their state benefits expire. Workers will receive an extra 13 weeks of federal coverage after their 26 weeks of state coverage runs out. The extended benefits are expected to aid 300,000 jobless individuals.

✓ The Housing and Urban Development Dept. will receive greater power to enforce fair housing laws if the Senate passes a bill that has recently come from the House. The legislation would create a panel of judges to hear complaints addressed to HUD. The judges would have the authority to issue cease-and-desist orders and assess fines. At present, only HUD has the power to conciliate such disputes.

✓ The Department of Energy has asked Congress for another $28.6 million to revise its conservation standards for buildings. This request comes after four years of work and expenditures of $25 million. During this period the DOE held 19 days of public hearings and received 14,000 pages of comments on the proposed regulations. The department's November projections indicate that the new standards would reduce America's energy consumption by only 0.6% between 1980 and 2020, as opposed to the original forecast of a 15% improvement.

✓ A compromise version of the Alaska Lands Bill (already passed by the Senate) will soon be presented to the House. The bill would set aside 104 million acres for national parks and wildlife refuges and would create stricter limits on oil and gas exploration. The pending legislation has created such a furor in Alaska that a referendum was recently passed instructing a state commission to reconsider Alaska's relationship to the federal government and her role in the union.

✓ Although the White House has not yet recruited a chairman for the government-sponsored Synthetic Fuels Corp., the search continues. Among the possibilities recently mentioned are Richard DeLauer, executive vice-president of TRW Inc., and Gordon Ahalt, senior vice-president of Ashland Oil Inc.

✓ Free health care for congressmen is currently costing taxpayers over $500,000 a year. Among the services being made available to our legislators are a complete medical staff, a pharmacist who dispenses free prescriptions, a fully equipped lab, and emergency equipment at three different locations.

✓ Census takers have recently discovered that nearly 80,000 residents in Washington, D.C., were completely bypassed in the first census count. The Census Bureau would not confirm the undercount, but it did admit that only 77% of the households in southeast and northeast Washington returned the census forms. Meanwhile, Census Bureau director Vincent Barabba has said that recounts will not be taken into consideration when congressional districts are apportioned.

✓ The National Commission on Unemployment Compensation has issued a report recommending that the national unemployment system be federalized and that benefits be indexed for inflation. The commission estimates that the indexing proposal will cost employers $5 billion a year.

✓ The Wind Energy Systems Act, which allocates $100 million toward the production of wind-generated electricity, was given final approval by the House of Representatives. Although several of America's largest companies (e.g., Boeing, General Electric, and Hamilton Standard) are already investing millions in wind energy systems, Congress thinks that these efforts are moving in the wrong direction because of their large scale. ■

## America's Reindustrialization (Cont. from p. 7)

maintaining full employment. The unwelcome recurrence of recessions in 1958, 1966, 1969, and 1973–74 left the policy advisers undeterred in their bipartisan program of planning for stability.

As recently as June 1980 senior presidential adviser Amitai Etzioni, in commenting on the recurrence of recessions during the decades of Keynesian fine-tuning, said that there was "too much consumption in relation to savings and investment."[3] Not enough was "plowed back" for adequate capital formation. Mr. Etzioni searched his sociologist's lexicon and came up with the term "reindustrialization." From June until the end of August this neologism remained an abstraction, a shorthand term expressing the government's need to deal with the planner's perennial nemesis, the unruly and kaleidoscopic marketplace, where outcomes of various social actions seldom conform to the prescriptions and timetables of regulation. Frank A. Weil, a former Assistant Secretary of Commerce under Carter, could only broadly describe that nemesis as "lagging productivity, a falling off of innovation, distortions in our process of capital formation, and the loss of global competitiveness."



The solution Weil suggested was a more "activist" industrial policy that would bring business, labor, and government together to "identify problems, articulate national goals, and specify ways to realize those goals." In keeping with the premises that underlie so much of modern policy discussion, a senior congressional staff economist remarked, "To some, it smells like planning.... Nobody is opposed to planning until they name the planners."[4] To his credit, Charles L. Schultze, chairman of the Council of Economic Advisers, describes himself as "wary" of some of the policy prescriptions under discussion. He also notes that as early as 1968 an American official presented a paper on "United States Industrial Policies" to the Organization for Economic Cooperation and Development. Schultze's wariness, however, doesn't preclude sizable government spending for the improvement of the economy's infrastructure, encompassing, for example, the refurbishing of the nation's highways, railroads, waterways, and deep-water ports to the tune of $585 billion over the next decade. The ostensible aim is to boost exports by sharpening America's competitive edge in international markets.

One could go back well before 1968 to trace the genesis of governmental prescriptions for industrial health, however. Michael A. Heilperin's *Studies in Economic Nationalism* (1960) is a scholarly survey of collectivist prepossessions from Aristotle's *Politics* through the mercantilist heritage expressed by Johann Fichte's *The Closed Commercial State* (1800) and the corporatist legacy of John Maynard Keynes. Friedrich A. Hayek, a noted economist of the Austrian school, has written about some of the issues raised by corporatism:

> It is a regrettable but undeniable fact that economics, more than other scientific disciplines, is liable to recurrent fashions and fads: the periodic reintrusion into professional discussion of popular superstitions which earlier generations of economists had successfully driven back into the circles of cranks and demagogues.[5]

The advocates of governmental economic planning in the 1980s have

> **"From 1960 to 1976 the average capital investment for new plant and equipment as a percentage of GNP was lower in the United States than in any other industrial nation."**

learned little from the discussions among economists in the 1920s and 1930s regarding the implications of just who does the planning and what that planning entails. Hayek notes that the debate over the virtues of planning

> turned mainly on the question of the justification of increasing productivity by substituting central planning for marketplace competition as the instrument for guiding economic activity. I don't think it can now be gainsaid by anybody who has studied these discussions that those hopes were shattered and that it came to be recognized that an attempt at centralized collectivist planning of a large economic system was on the contrary bound greatly to decrease productivity.[6]

And yet policy discussions continue as if there were no alternative to corporatism. When the Initiative Committee for National Economic Planning pushed for the Balanced Growth and Economic Planning Act of 1975, no one anticipated that the absence of any reference to the specific methods and powers required to implement the planning act would in effect give the committee carte blanche.

On August 28 President Carter announced that he will appoint leaders of government, business, and labor to an Economic Revitalization Board (ERB) to help plan a "long-range program" of industrial renewal. What is thus far envisaged is for the ERB to design an "industrial development authority," an agency that would draw on pension funds and other public and private capital to create jobs, particularly in those areas hard hit by the recession.

The creation of this agency is President Carter's response to the AFL-CIO's demand for a top-level advisory committee of industry and labor. Lane Kirkland, AFL-CIO president, is one of the selected heads of the ERB. In addition to his union activities, Kirkland is on the boards of directors of a wide variety of organizations, ranging from the Urban League to the Council on Foreign Relations. When commenting before a business audience in 1978 on his conception of government's proper role in the economy, he stated that he has "always believed that if socialism comes to this country it will come at the hands of ultra-conservative politicians using the public treasury to bail out collapsing corporate empires."[7]

Also chosen to sit on the ERB is Irving Shapiro, the chairman and chief executive officer of E. I. du Pont de Nemours & Company, one of the largest chemical companies in the world. (Du Pont earned $939 million last year on $12.6 billion in revenues.) In reiterating the theme of cooperation among all sectors of the economy—business, government, and labor—Shapiro described his reaction to Carter's request that he join the ERB by acknowledging that "[he] can't conceive of a situation where anyone would say no to a President" and added, "I'm not being dragged in though. The concept excites me." In a subsequent interview Shapiro elaborated by commenting, "The ERB has the potential for creating a major change in the relationship of government, industry and labor; of getting the adversary quality out of the relationship."

President Carter has also turned his attention to the short-term specifics of taxes and subsidies and their role in the "productivity crisis." The crisis is real enough. Until 1970 productivity growth in the private sector averaged over 3% a year, but that rate of growth declined to 1.8% per year during the period from 1970 to 1978. In 1979 productivity in the nonfarm private business sector actually declined. Despite enormous and growing needs for capital formation in this country—estimated at $4 trillion during the next decade— the capital stock has risen by a paltry 3% per year over the past five years, half the rate of the preceding decade.

Comparisons with other major industrial nations are less than encouraging. From 1960 to 1976 the average capital investment for new plant and equipment as a percentage of GNP was lower in the United States than in any other industrial nation. Today the average U.S. plant is 20 years old—8 years older than the equivalent West German plant and more than 10 years older than the equivalent Japanese plant. The ratio of R & D to output reached its peak of 3% in 1964 and has since dropped steadily, while the same ratios in Japan and West Germany have increased. Corporations in overseas nations account for nearly 40% of the patents issued in the United States, twice the ratio of two decades ago.

Carter's economic revival program includes proposed tax cuts amounting to $27.6 billion in 1981, cuts that would boost the 1981 budget deficit from the $30 billion to $36 billion. These proposals suggest that Carter recognizes, at least to some extent, the significant role that oppressive taxation plays in the productivity crisis. In 1930 local state and federal taxes represented about 10% of personal income. By 1940 this had doubled to 20%, and by the mid-1970s this had doubled again, approaching 40%. However, these proposals do not address the full extent of the tax burden and its most pernicious element, inflation, at all. Reduced government spending is not in the picture. Nowhere do these proposals suggest that the combined impact of taxes and inflation continues to take such a sizable bite out of the productivity of individuals and firms as to preclude any prospect of social stability and full employment. When the distortions in the economy caused by government manipulations of money and credit are added to the disincentive to produce caused by onerous taxation, we have a time-tested prescription for planned chaos.

When the government expands the supply of money and credit, consequent relative price distortions mislead entrepreneurs (individual private planners) about consumer preferences, and they make investments that subsequently prove to be unsustainable. The liquidation of these investments causes unemployment. The more erratic the patterns of money stock growth, the more severe the unemployment. During the 1970s budget deficits ballooned the money supply by 33%, but the nation's output of goods and services rose by just 15%. Consumer price increases outpaced money supply growth rates during this same period.

Some small businesses and others properly positioned within the ERB may benefit from the newly proposed accelerated and liberalized regulations governing business depreciation, the refundable tax credit, deductions on small business start-up costs, and the employer social security tax credit. All of the foregoing combined, however, will not abate the decline in productivity of those individuals and businesses staggering under the weight of continued inflation induced by a budget deficit. This inflation can only continue to consume personal and business capital and prop up an increasingly unwieldy capital structure subject to all the misallocations and bottlenecks of a stagnating economy.

In America's so-called reindustrialization we are witnessing what Ludwig von Mises, the preeminent economist of the Austrian school, termed the "crisis of interventionism."[8] When the major issue confronting the ERB is whether the agency should bail out "ailing" industries such as steel or provide help for new high-technology manufacturers such as the makers of semiconductors and other advanced electronic items, it's apparent that the "reindustrialists" don't grasp the nature of the issues and have in effect become the source of the problem for which they claim to have the solution.

## GOVERNMENT RECEIPTS MONITOR

On a quarterly basis, *Policy Report* presents three monitors of economic activity: "Government Expenditures," "Government Receipts," and "Inflation." This month the "Government Receipts Monitor" summarizes the latest levels and sources of the federal government's income.

RECEIPTS (annual rate in millions of $)

| | 1980 Second Quarter | 1980 First Quarter | 1979 Fourth Quarter | Average for Last Four Quarters |
|---|---|---|---|---|
| Net Receipts | 43,506 | 41,236 | 39,571 | 41,701 |
| Surplus or Deficit | −5,827 | −5,033 | −1,853 | −3,921 |
| Withheld Individual Income Taxes | 17,779 | 18,898 | 17,565 | 17,873 |
| Gross Corporate Income Taxes | 7,461 | 5,162 | 4,774 | 6,032 |
| Gross Employment Taxes and Contributions | 13,389 | 10,770 | 10,193 | 11,233 |
| Social Insurance Taxes and Contributions | 16,057 | 12,102 | 11,542 | 13,017 |
| Holdings of Public Debt Securities | 870,459 | 849,134 | 829,046 | 839,283 |
| Holdings of Agency Securities | 6,923 | 7,042 | 7,192 | 7,110 |
| Federal Securities Held by Public | 687,501 | 667,716 | 647,916 | 659,927 |
| Airport and Airway Trust Fund | 180 | 145 | 142 | 152 |
| Highway Trust Fund | 574 | 567 | 585 | 589 |
| Estate and Gift Taxes | 533 | 487 | 502 | 500 |
| Customs Duties | 593 | 595 | 626 | 623 |
| Miscellaneous | 1,311 | 801 | 908 | 952 |

Source: All data is derived from the *Treasury Bulletin*.



1 Ralph Bowen, *German Theories of the Corporative State* (New York: McGraw-Hill, 1947), pp. 3–4.

2 Murray N. Rothbard, "War Collectivism in World War I," in Ronald Radosh and Murray N. Rothbard, eds., *A New History of Leviathan* (New York: E. P. Dutton & Co., 1972).

3 *New York Times*, 29 June 1980.

4 *Washington Post*, 29 August 1980.

5 Friedrich A. Hayek, "The New Confusion about Planning," *Morgan Guaranty Survey*, 1976.

6 Ibid., pp. 66–67.

7 *New York Times*, 29 June 1980.

8 Ludwig von Mises, *Human Action: A Treatise on Economics* (Chicago: Henry Regnery, 1966), pp. 855–58.

## Letters to PR

The article "The Politicization of a Profession" (June) is an excellent article long overdue. I have several friends in the accounting profession to whom I would like to send this article. I would appreciate your sending along five more copies of the June issue at the single issue price.

David H. Padden
Chicago, IL

Be advised that I do not wish to renew my subscription. Without going into detail, I would like to say that I enjoyed *Policy Report*, but not to the tune of $15 per year. I wish you success.

Robert McDowell
Chapel Hill, NC

*Beginning with September 1980,* Policy Report *expanded to 12 pages and added several features. This represents an expansion of 50% for the same subscription fee. We hope this helps bring the high cost of* PR *down in terms of content and value.—Eds.*

With respect to the format of *Policy Report*, I would like to make a suggestion. The *Report* should be a bit more in depth. This would be accomplished by having either a longer feature article or a few shorter articles on the same theme. Otherwise, keep up the great work!

Frank Vorhies
Boulder, CO

*We are happy to have done both! The August* PR *presented a debate on supply-side economics, and the expansion to 12 pages makes longer articles possible.—Eds.*

The "Laffer curve" is not the linchpin of supply-side economics [see August 1980 *PR*]. My exposition of supply-side isn't in terms of aggregates. Rather, I stress that changes in marginal tax rates cause changes in relative prices. I also discuss the "Laffer curve" (before Laffer) redrawn as you suggest. See my 1971 book on the Soviet economy and my article, "Idealism in Public Choice Theory," *Journal of Monetary Economics* 4 (1978), especially pp. 610–612.

Paul Craig Roberts
Center for Strategic and International Studies
Washington, D.C.

*While we are happy to recommend Dr. Roberts's works to our readers, we feel that the public debate on tax cuts and supply-side economics has focused on the analysis supplied by Arthur Laffer, and therefore the debate in the August issue focused on the Laffer-Wanniski contentions.—Eds.*

*Policy Report* accepts letters for this column. All letters, in order to be considered for publication, must be signed and brief. *Policy Report* reserves the right to edit all letters for space. Address correspondence to:

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**POLICY REPORT**

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- **Introducing a New Column of Book Reviews**
- **Trade Regulations/ Department of Interior Watch**

# "To be governed..."

**At least he doesn't drink**

Voters in South Carolina have received a warning from Senator Ernest Hollings to be skeptical of ratings of lawmakers made by special interest groups. Example cited: A religious group gave a perfect score of 100 on its "morality index" to a congressman indicted in the FBI's Abscam operation.

—*U.S. News & World Report,* Aug. 25, 1980

**Just in case**

Five billion stamps with no denominations are printed and stored by the Postal Service. The service wants to raise the basic letter rate to 20 cents from 15 cents, but the stored stamps can be sold for any rate that is eventually allowed.

—*Wall Street Journal*, Aug. 22, 1980

**Ignorance is bliss**

"If the question [of Conrail's problems] is money, we don't even know who to give it to," says federal Transportation Secretary Neil E. Goldschmidt.

—*Business Week,* Sept. 1, 1980

**So much for free enterprise**

Once they reach the top, many executives develop another ambition—*government service*. Some 38 percent of the chief executives queried by Arthur Young Executive Resource Consultants are interested in a top federal post.

The actual acceptance rate would be even higher, says L. Parker Harrell, an Arthur Young official. "After all, an actual invitation would be couched in terms more attractive both to the ego and sense of duty," he says.

—*U.S. News & World Report,* Aug. 18, 1980

**Finders keepers, losers weepers**

Government scientists say, due to bookkeeping problems, they cannot account for more than 34 tons of enriched uranium at the Feed Materials and Production Center in Fernald, it was reported yesterday.

The *Cincinnati Post*, which requested the information under the U.S. Freedom of Information Act, said documents also reveal that about 4,850 tons of uranium in various forms have leaked into waterways or the air since the facility opened in 1952.

—*Washington Star,* Sept. 6, 1980

**Back in bed**

[Chicago] Mayor Jane Byrne, who flirted with an endorsement of President Carter last fall only to end up jilting him in favor of Sen. Edward M. Kennedy (D.-Mass.), was coaxed back into the Carter fold today with the help of more than $100 million in federal largesse.

—*Washington Post,* Sept. 10, 1980

**In the front door, out the back**

The Carter campaign has taken off the television networks a campaign advertisement showing a grateful woman thanking the President for inviting her to the White House after it was discovered that in fact the woman not only left the White House in tears, but also that she now supports Ronald Reagan.

—*New York Times,* Sept. 9, 1980

**Toeing the party line**

Republicans saddled with a former Nazi as their congressional nominee in one suburban Detroit district learned Friday that the party candidate in another suburban congressional race is a mental patient....

Alfred L. Patterson, 25, a patient in a state mental hospital, said he spent $30 to $40 on his winning GOP congressional campaign in the 17th District. He made no public appearances and didn't even vote—he couldn't get out of the hospital—but he outpolled two other candidates.

—*Chicago Tribune,* Aug. 10, 1980

**$8 billion—petty cash?**

The [New York] State Senate's Republican leaders filed suit against Governor Carey's administration last week in an effort to stop the spending of $8 billion in state revenues that are not under control of the Legislature....

The State Budget Director, Howard F. Miller, said the Carey administration would fight the charge, calling the lawsuit "one of the silly things one does on a hot August afternoon when there's nothing else to do."

—*New York Times,* Aug. 10, 1980

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