

POLICY REPORT

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The Flat-Rate Income Tax: An Analysis

Question: What do Phil Crane, Richard Viguerie, Ralph Nader, and Bill Bradley have in common?

Answer: Each is an advocate of some form of a flat-rate tax proposal. These four influential political leaders cover both the left and right of the current American political spectrum but each is part of a broadly based consensus to radically reform the U.S. tax system.

Under all of the flat-rate tax proposals, nearly the entire personal income section of the U.S. tax code would be discarded and replaced with a constant (or slightly variable) rate of taxation on personal income. In their purest form, the flat-rate tax proposals would apply a single rate to *all* personal income — no deductions and no exemptions. (In order to raise current levels of revenue it is estimated that this rate would have to fall somewhere between 15 and 20%.) It is generally believed that such a far-reaching proposal would stand no chance of passage so several modified versions of such a scheme have been drawn up. Some of these variations impose a slight progressivity on the rate of taxation while others would retain such widely used deductions as mortgage interest payments and charitable contributions. Other plans utilize some combination of these modifications.

Although there are no serious signs that the flat tax rate is just around the corner, it is a movement that is gaining momentum. Within the last two months, the House of Representatives has seen the introduction of eight flat-tax bills while the Senate has encountered six comparable bills. The flat-rate tax proposal may soon receive its strongest

push yet — from the Reagan administration. A study by the Treasury Department is due to be released next month, and OMB head David Stockman has said that the administration is considering submitting a flat-rate tax proposal to Congress in January along with next year's budget. Although President Reagan himself has stopped short of actually endorsing the tax, only last month he described the idea as "very tempting." By

"Flat-rate tax proposals do not fully address the problem of the relative price and income distortions engendered by the present tax system."

no means has this push originated with Republicans. For instance, the Democrats' June midterm convention in Philadelphia endorsed a lower-rate, broad-based income tax scheme that resembles some of the more moderate proposals. The convention noted that "... common sense dictates that (the present) convoluted system be dramatically simplified."¹

A brief examination of two proposals before the Congress should give us a better idea of what the flat-tax movement is all about. Perhaps the most radical of the congressional proposals is the one by Rep. Phil Crane (R-Ill.) and Sen. Jesse Helms (R-N.C.). This bill consists of a flat 10% tax rate combined with an exemption of \$2,000 per return. No deductions would be allowed. It is estimated that this bill would decrease the govern-

ment's revenue intake by approximately \$75-100 billion. One of the more moderate bills is the one sponsored by Rep. Richard Gephardt (D-Mo.) and Sen. Bill Bradley (D-N.J.). The tax rate would be 14% on income up to \$25,000 for single persons and \$40,000 for couples. Income above these levels would be taxed at either 21 or 28%. The exemption would be increased to \$1,500 per person and the following deductions would be retained: home mortgage interest, charitable contributions, state and local income taxes, property taxes, Social Security and veterans' benefits, and employee business expenses. This plan is designed to raise current levels of government revenue.

The Flat-Rate Tax: An Assessment

As President Reagan has remarked, flat-rate tax schemes are very tempting. Everyone agrees that current tax laws are ridiculously complicated and expensive. The status quo strongly encourages overinvestments in both tax shelters and legal services because of the exorbitantly high rates of taxation facing certain income brackets and sources of income. Since the rest of the American economy is taxed so heavily, any area that is given a "tax loophole" (e.g., employer-funded pension plans) results in an artificial stimulation of that area because other sectors are being distorted by previously existing taxes. The solution to this problem is to lessen or remove the taxes on these other sectors, and the flat-rate tax is at least a move in the right direction. "Equal" taxation of all sources of income will not remove these distortions but perhaps it can be expected to lessen them.

Another virtue of the flat-rate scheme is that a simplification of the tax code

This article was prepared by the *Policy Report* staff.

The Fallacy of Regulation

It had to happen. The Justice Department is investigating six Japanese electronics companies in an effort to show a conspiracy to set prices too high on the 64K RAM computer chip.

That's not too surprising, of course, except that in this case the Commerce Department is simultaneously investigating whether the companies are "dumping" their chips at below-market value.

We are reminded of a section of R.W. Grant's little poem, "The Incredible Bread Machine":

"Now let me state the present rules,"
The lawyer then went on,
"These very simple guidelines
You can rely upon:
You're gouging on your prices if
You charge more than the rest.
But it's unfair competition
If you think you can charge less.
"A second point that we would make
To help avoid confusion:
Don't try to charge the same amount;
That would be collusion!"

It is presumably obvious to anyone, even a bureaucrat, that the firms cannot be simultaneously selling their products both above and below the market level. What may not be as obvious is that *either* charge by itself is absurd. There is a simple test to determine what the market price of a good is: A market price is the price at which a buyer and seller make an exchange, assuming there is no coercion involved.

Contrary to what might appear to be the case, cost does not determine price. Price is determined by supply and demand. If a painter spends two years labor and thousands of dollars for canvas and paint to produce a portrait that no one wants to buy, his costs are irrelevant. He will sell it for whatever he can get, no matter how far below his costs the price may be. One hopes that the government would not then compound his difficulties by prosecuting him for "dumping" paintings below cost.

If a selling price appears to be below cost — or below the "market level" — then consumers benefit. If sellers conspire to set a price above the market level, consumers will adjust their demand and probably buy less of the product. (Such cartels never work for long in practice, but that's not our point here.) In any case, there is no abstract "market price" to be determined by government and enforced. The market price fluctuates every day with changes in supply and demand. The government indulges in what F.A. Hayek calls the "pretense of knowledge" if it presumes to know what the

"proper" price of any exchange is.

The absurdity of regulation goes well beyond price-setting, however. Two other recent examples, separate but perhaps related, illustrate the point as well.

A few months ago an arbitrator ruled that a worker's inability to read English shouldn't disqualify him from becoming a janitor. The firm said the worker wouldn't be able to read warning labels or the names of certain tools. The arbitrator said, however, that if the name of the tool is written on a piece of paper, someone else can help the janitor. Indeed, that might be a great way to solve the unemployment problem: require firms to hire clerical assistants for janitors.

The California Fair Employment and Housing Commission has issued new regulations that would allow the commission to fine employers who allow workers to tell ethnic jokes on the job or force them to speak only English. Now we don't intend to defend ethnic jokes, but we must ask, Is no area of life to be free of government regulation? Surely the First Amendment, if not common sense, would suggest that jokes — however offensive — should be outside the scope of the law.

Interestingly, however, there are *regulations* that do unfairly discriminate against Americans who can't speak standard English. In many states, for instance, to work as a barber a person must pass a written test administered only in English. If his potential customers are in the barrio or the ghetto, his Spanish or Black English may be perfectly sufficient for communicating with them; but he cannot get a license because of his inability to pass an irrelevant test. Those who are concerned about language discrimination should work on repealing such laws and let society pursue its natural course with regard to employment requirements.

The examples cited here have received some (not much) attention because they seem to be extreme cases, and they probably are. But they are not fundamentally different from regulation in general. Once it is agreed that government has the authority to regulate the behavior of consumers and producers, there is no clear stopping point. Instead, regulation must be challenged on basic principles: the moral principle of individual freedom — that a person should be free to take any action he chooses so long as he does not violate the equal rights of others — and the inductive economic principle that the freely functioning market process will inevitably best satisfy the desires of market participants, though at any given point that may not be obvious.

Whether regulating the telling of jokes, the price of milk, or the features on a car, regulation can only bring about a result different from that desired by consumers making their choices in the marketplace. ■

Flat-Rate Tax (Cont. from p. 1)

would decrease the discretion of the Internal Revenue Service, one of America's largest and most powerful bureaucracies. Hence, the plan would strike at least a partial blow for civil and economic liberties. In addition, the serious problem of "bracket creep," where inflation pushes people into higher and higher tax brackets, would be eliminated. The only way for the federal government to raise additional tax revenue would be to publicly announce a hike in the tax rate — surely a politically unpalatable step for most politicians.

A not insignificant virtue of the flat-rate tax is that it would strike a blow at the egalitarianism that is the basis for so much mistaken government policy. Graduated taxation is based on the idea that government ought to redistribute income. This concept is simply wrong. People should have a right to keep what they have freely and fairly earned, whether it is more or less than someone else thinks they "ought" to have. (In fact, differences between rich and poor tend to be reduced in a free competitive economy, and in the long run graduated taxation reduces this tendency, but we are not primarily concerned here with the practical aspect of egalitarian policies.) Moving to a flat-rate tax system would be a powerful symbol that we reject the leveling egalitarianism of graduated taxation.

Despite these important virtues, it is doubtful if many of the flat-rate taxation schemes represent a step in the right direction. While the Crane-Helms proposal is to be strongly commended because it attempts to reduce the tax burden on Americans, most of the other proposals do not address this problem at all. All that most of these plans try to do is to devise a more efficient way for the federal government to capture revenue (and hence, resources) from the private sector. The true goal of tax reform should be to *decrease* the ability of the public sector to conscript resources from the private sector. By making existing levels of revenue collection more efficient, not only do we distract attention from the

real problem (the burden of government spending) but we may even hurt the chances for true tax reform by making present levels of federal spending appear more tolerable. Insofar as flat-rate tax plans are combined with true tax and budget cuts, they should be applauded. Without such provisions they deserve serious criticism.

Another problem with the flat-rate tax proposals is that they do not fully address the problem of the relative price and income distortions engendered by the present tax system. The idea of "neutral taxation" is, of course, a myth.² *All* taxation will result in the diversion of resources from their most highly valued uses because the tax will alter the relative prices established by the market. While different systems of taxation will create different kinds of distortions, it is very difficult (if not impossible) for the economist to assess which series of distortions do greater damage to individuals' preferences relating to economic growth and prosperity. Therefore, if we are interested in eliminating or reducing these distortions the only surefire way of doing so is to *cut* taxes by a significant amount. Trading in one form of taxation for another is only trading in one set of distortions for another. While flat-rate taxation may be a move in the right direction it is an inadequate move and one that may not be conducive to further progress.

Keeping the Proposals Intact

Two of the main gripes the advocates of flat-rate taxation have against the current tax code are its complications and its concessions to vested interests in the form of various deductions and loopholes. It is a fallacy to assume, however, that any new scheme of taxation, no matter how thoroughly reworked, will not suffer from the same problems. The loopholes that currently exist are not an accident — they exist for various reasons. Different interest groups benefit from these loopholes, and such interest groups made sure the loopholes were incorporated into the tax code. Similarly,

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Flat-Rate Tax (Cont. from p. 3)

it is extremely unlikely that a simple and fair system (however defined) would emerge from a plan for flat-rate taxation. Once the tax lawyers and various lobbyists swing into action the final proposal is unlikely to resemble the plan as originally envisioned by its supporters. The Gephardt-Bradley plan described earlier shows that this process is already taking place. Once several deductions are left intact every special interest lobby will be making its pitch. Gephardt himself said that he moderated his plan because "You get things done politically in this country by doing things in the middle."³ But if this is the case, what will happen to the positive attributes of the original proposal?

After the Congress has just passed the largest peacetime tax increase in Amer-

ican history, it seems unlikely that members of Congress will view the flat-rate tax option as a way of cutting taxes. Indeed, at a recent Washington symposium on the flat-rate tax most of the participants used "flat-rate tax" and "broadening the tax base" interchangeably. Clearly, their real goal is to wipe out all the deductions and exemptions with one stroke, thus dramatically increasing taxes if no other measures are taken at the same time. Sen. Bradley has suggested that if his proposal is viewed as too radical, it could be implemented in steps — eliminating the "loopholes" first and considering rate changes later. If that happened, what is the likelihood that the time for lowering the rates would ever arrive?

The flat-rate tax is certainly tempting,

but we must not be diverted from the main point. The chief problem with our present tax system is its sheer size: It takes too much money out of the economy, diverting resources from consumer-directed uses to politically favored plans. The goal of those who want individual freedom and a revitalized economy must be to lower the tax burden, not to shift it. If that can be done in conjunction with a simplified system, fine. But we must not let the temptress of simplification divert us from the goal of tax reduction. ■

¹"A Push for 'Flat-Rate' Income Tax," *San Francisco Chronicle*, July 19, 1982, pg. 8.

²For an elaboration of this argument, see Murray Rothbard, "The Myth of Neutral Taxation," *Cato Journal* 1 (Fall 1981).

³"A Push for 'Flat-Rate' Income Tax."

It's Time to End the Nuclear Subsidy

By Bruce Bartlett

On February 2, Vice President Bush, Energy Secretary Edwards, and Commerce Secretary Baldrige held a closed-door meeting with top officials of the nuclear power industry. The problem under discussion was that although President Reagan holds pro-nuclear views and has moved to reduce restrictions on nuclear power development, this has been insufficient to revive the moribund industry. What the nuclear industry officials wanted was a \$50 billion federal loan program to get them back on their feet.¹

To its credit, the administration did not endorse the bailout scheme. But on the other hand, it continues to sanction massive federal subsidies to the nuclear power industry in the face of growing evidence that such subsidies are wasteful and counterproductive. It's time to eliminate them with the free market deciding

once and for all whether we need nuclear power.

Three recent studies have attempted to measure the magnitude of the federal subsidy of nuclear power. Although they come to different conclusions, due to different methodologies, each study puts the cumulative subsidy into the tens of billions of dollars.

In 1978 researchers at the Pacific Northwest Laboratory, operated by the Battelle Memorial Institute for the U.S. Department of Energy, estimated the cost of incentives for nuclear power to the federal government at \$18 billion over 30 years. They estimated an expenditure of \$15.1 billion on research and development (nuclear power was basically invented as a product of wartime research on the atom bomb), \$1.1 billion in regulatory costs, and \$1.8 billion from investment in uranium enrichment plants. These calculations, however, exclude such important incentives to the nuclear power industry as the Price-Anderson

Act, which limits the liability of nuclear plants in the event of an accident, and other federal uranium policies.²

In 1979 the U.S. General Accounting Office attempted to measure the nuclear subsidy, at the request of Sen. John Melcher of Montana. The GAO calculated the subsidy for three fiscal years — 1976, 1977, and 1978 — and estimated the cost as follows:

Fiscal Year	1976	1977	1978
	(millions-\$)		
Research and Development	936	989	1,196
Uranium Enrichment	120	180	220
Regulation	221	213	240
Total	1,277	1,382	1,656

From these data the GAO estimated the subsidy per kilowatt hour of nuclear-generated electricity to be .51 cents in 1976, .57 cents in 1977, and .62 cents in

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1978. Since the estimated cost per kilowatt hour of nuclear-generated electricity is about 2.2 cents, this implies about a 25% federal subsidy, raising the real cost of nuclear power above that of coal-generated power.³

The third and most important study of nuclear power subsidies was recently completed by the Department of Energy itself. According to DOE, nuclear power has received almost \$40 billion in subsidies over the last 30 years, and in the absence of such subsidies nuclear power would be twice as costly to consumers as conventionally produced power. The DOE study estimates that nuclear power has received \$23.6 billion in subsidies for research and development; \$237.4 million to promote foreign reactor sales; \$2.5 billion for uranium market promotion; \$7.1 billion in fuel enrichment pricing aid; and \$6.5 billion for management of wastes, mining spoils cleanup, and unpaid decommissioning costs. The total is \$39.9 billion in 1979 dollars. The estimated subsidy per kilowatt hour comes to between 1.6 cents and 2.5 cents.⁴

These estimates only calculate direct subsidies. There are also implied subsidies in the form of the Price-Anderson Act and future costs of permanent disposal of nuclear waste and the decommissioning of nuclear plants at the end of their useful life. Since there are no provisions for these future costs in the current rate base, it is more than likely that the federal government will end up bearing them. Thus they constitute an implied current subsidy.

No one knows what the implied subsidy of the Price-Anderson Act is, partly because no one knows what the real cost of a nuclear accident might be. But obviously the damages for a serious accident could easily run into the billions of dollars. The cost of obtaining private insurance against such an accident would clearly be prohibitive — if such insurance could be obtained at all. This is the value of Price-Anderson, which limits the liability for any nuclear incident to \$560 million. Moreover, the federal government itself is liable for \$500 million of

□ A 1982 General Accounting Office report found that Government Printing Office employee salaries greatly exceeded those of similar employees found in the private sector by more than 28% in one area. Labor costs account for 80% of the GPO's overhead costs, compared to 40 to 50% in the private sector. As a result, the typical job produced by the GPO is likely to cost three times as much as a similar privately produced printing.

□ In testimony before a Joint Economic Committee subcommittee, Federal Trade Commission Chairman James Miller advocated the lifting of the special antitrust status that has given the U.S. Postal Service a monopoly over the delivery of first-class mail. Miller claimed that the introduction of competition into first-class mail delivery would help consumers by improving service and lowering postal rates. Although the Reagan administration has yet to take a formal position on this subject, Miller said that "competition will best serve the public and I am aware of no factual basis" for retaining the postal monopoly.

□ Another GAO study has concluded that offshore oil and gas sales will not produce the amount of revenue that the Reagan administration has projected. It was first estimated that lease sales and royalties would collect \$18 billion in fiscal 1983 but this figure was quickly lowered to \$15.7 billion because of depressed oil prices. The GAO has suggested that the Congressional Budget Office figure of \$12.8 billion is far more reasonable. The difference between the two figures is largely attributable to the administration's projections of revenue from offshore sales in the Gulf of Mexico. Most members of Congress have sided with the GAO. Rep. Edward Markey (D-Mass.) said that the GAO report "demonstrates the willingness of Interior to manipulate its financial projections for the appearance of deficit reduction."

□ The Federal Election Commission has recently released information on PAC (Political Action Committee) activities over the last year and a quarter. As of March 31 there were 2,028 corporate and trade association PACs. By the end of March, business PACs alone had given congressional candidates for this year's upcoming election \$16.3 million. The top four PAC contributors over this period were the American Medical Political Action Committee, the Realtors Political Action Committee, the Machinists Non-Partisan Political League, and the American Bankers Association BANKPAK.

□ The median income for a one-earner family of four is projected to hit \$23,895 in 1982. That represents a 114% increase over 1972. However, its federal income taxes rose by 155% and social security taxes by 242%, according to the Tax Foundation. The result is that in constant 1972 dollars, the family's income has fallen from \$9,702 to \$8,543, which represents a 12% loss of purchasing power in 10 years.

□ While President Reagan urges voluntary effort to meet "national needs," the government of Washington, D.C., is forbidding Judith Heintz to operate a day care center called The Shoe in her home. A neighbor complained that the center violates a 1925 ordinance forbidding businesses in residences. Other neighbors and parents of Shoe children marched on city hall to keep the center open, but a D.C. Superior Court judge ordered it closed, and city officials came to enforce the order. ■

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Nuclear Subsidy (Cont. from p. 5)

the \$560 million, with industry liable for only \$60 million per incident. Although the federal liability is being phased out, the \$560 million "cap" is retained. In any case, there is little doubt that if a serious nuclear accident were to occur the federal government would still end up bearing much of the cost, regardless of its legal liability. Although we cannot quantify the subsidy implied by Price-Anderson, we can conclude that it is substantial since it is universally agreed that the nuclear power industry could not exist without it.⁵

In 1978 DOE estimated a charge of \$4.6 billion to permanently deal with the storage and disposal of nuclear waste. The following schedule shows the outlays DOE believes will need to be covered:⁶

Facility or Service	Outlays To Be Covered (millions of 1978 dollars)
Away from reactor storage	\$ 275
Transportation to repository	100
Encapsulation facility	1,325
Geological repository	2,141
Research and development	560
Government overhead	234
Total	\$4,635

The charge necessary to cover these outlays would amount to .1 cents per kilowatt hour of nuclear power generated. But once again it must be noted that these charges are not now being collected. Therefore, there will have to be steep future increases in utility rates or the taxpayer will ultimately bear the costs. This situation evoked the following response from Maurice Van Nostrand, then serving as chairman of the Iowa State Commerce Commission, which regulates utility rates in Iowa, at a congressional hearing in 1978:

I find totally distasteful even the possibility that some of those costs are not being paid currently and that Iowans sometime in the future are going to be forced to pay not only the costs from some electricity they used but some carryover costs from some electricity consumed long ago. In the present situation, I think that is exactly what we're locking in for future taxpayers.⁷

In addition to the future costs of permanent waste disposal, one must also include decommissioning costs. The Battelle Memorial Institute put this money cost at between \$42.1 million and \$50.2 million for a single 1,175 megawatt power plant. Commonwealth Edison, the nation's largest generator of nuclear power, puts these costs at .02 cents per kilowatt hour.⁸ However, these are costs which could easily escalate and ultimately fall on the taxpayer, making them another implied subsidy for nuclear power.

Of course, on the other side of the coin, the nuclear power industry bears a heavy burden of government regulation.⁹ But these costs could be greatly reduced if the industry would standardize the design and operation of nuclear plants, rather than designing and building each plant from scratch.¹⁰ In any case, government subsidies are not a proper corrective for government regulation. If regulation is excessive it should be reformed; if it is unnecessary it should be eliminated.

There is now a growing body of literature on the economic effects of government subsidies to business.¹¹ One of the most interesting findings is that energy production subsidies, paradoxically, will actually increase U.S. dependence on imported oil. According to a recent study by Professors William J. Baumol of Princeton and Edward N. Wolff of New York University, any fuel-output subsidy which causes an otherwise unprofitable expansion must yield an incremental fuel output smaller than the increment in energy input plus the energy opportunity cost of other inputs. In other words, more energy will be used in

the process than is produced.¹²

For these and other reasons — not the least of which are philosophical — the U.S. should eliminate all subsidies to nuclear power. My guess is that we would soon find sharp increases in rates for nuclear power production, making it vastly more costly than other alternatives, including conventionally produced power, conservation, and alternative energy sources. ■

¹Joanne Omang, "Nuclear Industry Asks \$50 Billion in U.S. Loans," *Washington Post*, February 4, 1982.

²B.W. Cone, et al., *An Analysis of Federal Incentives Used to Stimulate Energy Production* (Richland, Wash.: Pacific Northwest Laboratory, December 1978).

³Comptroller General of the United States, *Nuclear Power Costs and Subsidies* (Washington: U.S. General Accounting Office, June 13, 1979). See also Senator Melcher's remarks in the *Congressional Record*, June 18, 1979, pp. S 7863-6.

⁴U.S. Department of Energy, Energy Information Administration, *Federal Support for Nuclear Power: Reactor Design and the Fuel Cycle* (Washington: U.S. Government Printing Office, 1981).

⁵U.S. Congress, House of Representatives, *Nuclear Power Costs: Twenty-Third Report by the Committee on Government Operations* (Washington: U.S. Government Printing Office, 1978), pp. 45-48; Comptroller General of the United States, *Selected Aspects of Nuclear Powerplant Reliability and Economics* (Washington: U.S. General Accounting Office, August 15, 1975).

⁶U.S. Department of Energy, Assistant Secretary for Energy Technology and Director of Energy Research, *Preliminary Estimates of the Charge for Spent-Fuel Storage and Disposal Services* (Washington: U.S. Department of Energy, July 1978), p. A-9.

⁷Quoted in U.S. Congress, *Nuclear Power Costs*, p. 16.

⁸Cited in Comptroller General, *Nuclear Power Costs and Subsidies*, p. 11. See also U.S. Congress, *Nuclear Power Costs*, pp. 22-25.

⁹U.S. Department of Energy, Energy Information Administration, *Nuclear Power Regulation* (Washington: U.S. Government Printing Office, 1980); Elizabeth Rolph, *Regulation of Nuclear Power: The Case of the Light Water Reactor* (Santa Monica, Calif.: The Rand Corporation, June 1977).

¹⁰U.S. Congress, Office of Technology Assessment, *Nuclear Powerplant Standardization: Light Water Reactors* (Washington: U.S. Government Printing Office, April 1981).

¹¹See, for example, U.S. Congress, Joint Economic Committee, *Federal Subsidy Programs* (Washington: U.S. Government Printing Office, 1974).

¹²William J. Baumol and Edward N. Wolff, "Subsidies to New Energy Sources: Do They Add to Energy Stocks?" *Journal of Political Economy* 89 (Oct. 1981): pp. 891-913.

Competition, Communication, and Cooperation: Private Property vs. Political Processes

By Dwight R. Lee

It is not uncommon to hear the view expressed that an economy based on private property and exchange rewards competitive rather than cooperative behavior. In this view, a major advantage to be realized from organizing economic activities collectively is to be found in motivating a spirit of cooperation and a sense of community. The virtues of collective action and the abuses of private property dominate the rhetoric of social cooperation, but in few cases is the rhetoric more at variance with the reality. Private property is the single most important social institution for facilitating the communication and the consideration of others upon which genuine and productive social cooperation depends. Indeed, without the cooperative behavior motivated by private property, the breakdown in communication and consideration that invariably accompanies collective, or political, action would be even more disruptive than it is.

It first has to be recognized that no social arrangement will be able to eliminate competition. Competition is the direct result of an inescapable condition — scarcity. As long as our productive capacity is inadequate to meet our insatiable demand for more (and it always will be), there has to exist some means for rationing scarce resources among alternative uses and users. There are many ways of rationing, e.g., first come-first serve, brute force, political influence, willingness to pay, good looks, and personality. But each form of rationing will reward certain types of behavior, and people will compete with each other accordingly. When desirable, but scarce, things are allocated on the basis of good looks and personality, for example, peo-

ple predictably take pains with their appearance and attempt to be pleasant. Competition in one form or another is simply inevitable.

Communication, Honesty, and Concern for Others

The important concern then is not over whether we should have competition or not. The real concern is to arrange incentives so that competition results in the efficient use of our resources (directs them into their most valuable

"Private property is the most important social institution for facilitating genuine and productive social cooperation."

employments). This is clearly no easy task. Each resource could be put to, quite literally, millions of different uses. No one individual can directly have more than very local information on the value of resources at his command. How are we each to know, when making resource use decisions, the value that others could derive from those resources? And what motivation would each of us have to give full consideration to the resource concerns of others even if they were known? In other words, a rather utopian set of conditions has to be realized if there is to be hope for the efficient resource allocation. First, every individual would be able to quickly and easily communicate to all others the value he places on all resources. Second, everyone would have to be completely honest in their communications: No one could exaggerate the benefits received from ad-

ditional resources. Finally, everyone would treat the concerns of others as their own. Everyone would be willing to relinquish a resource or product to the individual who communicated the greatest desire for it.

This extreme degree of communication, honesty, and concern for others may seem to be the very antithesis of people competing against each other, no matter what form that competition may take. But in fact the only hope for coming close to this cooperative ideal, short of universal and genuine sainthood, is found in the market competition that arises from the private ownership and control of resources.

When resources are privately owned and exchanged, people compete with each other through their willingness to pay for those things they want. If you want to purchase something from a private owner you will generally have to pay at least as much for it as others are willing to pay. Therefore, the market prices that materialize from private ownership and exchange are the means whereby others communicate to you the value they place on different resources. Similarly, your willingness to pay the market price for a product provides information to others on its value to you.

Honesty can be expected to prevail in this communication process since it is rarely in anyone's interest to refuse to reveal the prices they are willing to pay. Market participants have a strong motivation to assess the value they can realize from different products and have no motivation to communicate their desire for more of a product unless it is honestly worth more to them than the market price. This is not only an honest response, it is also a response that gives full consideration to the desires of others. When an individual decides that

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✓ Washington Update

✓ President Reagan has declared his unwillingness to sign the Law of the Sea Treaty because of his objections to provisions governing deep-sea mining. In a statement released at a State Department briefing, Reagan noted that (1) the future development of such deep-sea resources as manganese and cobalt would be deterred; (2) America did not have a veto power over Treaty amendments; (3) the Treaty may lead to transfer of mining technologies to unfriendly nations; and (4) there is no assured access for future qualified deep-seabed miners.

✓ New rules that would allow the use of high-sugar cereals in the WIC nutrition program are being delayed until after the November elections in order to tone down any resulting controversy. If the new rules are adopted, the federal government will start using presweetened, high-sugar cereals and chocolate milk in the food packages distributed to about 2 million women and children. This government food plan was funded at \$900 million for the past year.

✓ The Federal Trade Commission made an important change in its anti-trust policy when it rejected a previous judgment that barred the *Los Angeles Times* from giving preferential rates to high-volume advertisers. Commission officials said that the unanimous decision to eliminate this restriction represents an end to enforcement of the Robinson-Patman Act of 1936. This act made it illegal for manufacturers or distributors to price discriminate against small firms in favor of their larger customers unless there was a clear cost savings involved.

✓ Another important change in anti-

trust policy came when the FTC declared its intention to beef up its enforcement of laws prohibiting resale price maintenance. The first example of this shift came when the FTC, in a reversal of an earlier ruling, ruled against the practice of Russell Stover's candy manufacturers requiring retailers to charge a fixed price for the candy. The new ruling claims that resale price maintenance has led to higher retail prices.

✓ Several members of Congress are drawing up legislation which would excuse the timber industry from federal contracts which obligate timber companies to cut down over \$1 billion worth of wood in public forests. Industry representatives claim that it would be impossible to sell the wood in today's depressed timber markets and that an enforcement of the contracts would bankrupt many of the companies in question. Informal estimates by the USDA claim that the Treasury would lose approximately \$1.3 billion in forgone revenues if the contracts were terminated.

✓ The Reagan administration is considering making significant changes in the Hill-Burton Act of 1946, which requires that hospitals provide free medical care for the poor. Under current rules, this care, which is covered by federal grants, must amount each year to at least 10% of the hospital's construction costs or 3% of its operating costs. If these figures are not met, any remaining obligations are carried over into the next year. The proposed new regulations would have two main parts: They would substantially weaken the requirement that hospitals carry over unmet obligations and would eliminate the requirement that notices be posted informing hospital patients about the Hill-Burton

Act. From 1946 to 1981, nearly \$6 billion in federal aid was disbursed through the Hill-Burton program.

✓ A U.S. District Court has recently ruled that the Environmental Protection Agency cannot be released from its five-year agreement to establish a national water clean-up program and declared that the EPA "must be pushed to work harder." This ruling requires the EPA to continue with its earlier plans to establish water pollution controls for 23 major industries and 65 leading pollutants within the next three months. The agency is expected to appeal the deadline date, which is considered impractical by many agency officials.

✓ In a 5-to-4 ruling, the Supreme Court decided that victims of fraud or manipulation in the commodities trading industries can sue for damages in the federal courts. As a result, commodities futures brokers, merchants, and even exchanges are now vulnerable to million- and billion-dollar private suits as well as federal enforcement efforts. A number of pending suits were involved in this ruling, including the recent dispute over the Hunt family speculation in silver.

✓ The Environmental Protection Agency has released information which indicates that most air pollution monitors have systematically underestimated the levels of toxic lead pollutants in the air. This memo, which was obtained under a Freedom of Information Act request, had previously been kept confidential by EPA officials. The official who wrote the memo noted that "the vast majority of lead monitoring which has been done in the past has been at sites which were not designed to measure maximum lead concentrations." ■

Competition and Cooperation (Cont. from p. 7)

the value of a product is not worth the price, he is in effect saying, "Someone else is honestly telling me that the product is worth more to him than it is to me, so I will let him have it."

This system of communication, honesty, and concern obviously does not work perfectly. For example, because of transaction costs market prices will not always reflect accurately the value of resources and products to others. Some people will end up purchasing products that are worth somewhat more to others. Because it is sometimes difficult for consumers to determine quality it is occasionally possible for sellers to realize temporary advantages by dishonestly representing their products.¹ But despite these imperfections the advantages we all realize from private property, market exchange, and price competition are truly awesome. We are able to generate enormous wealth with our limited resources because the information and incentives provided by free-market competition allow each of us to interact cooperatively and honestly with literally hundreds of millions of people around the world.

Political Communication

Unfortunately, the very success of market processes at providing general benefits by allowing resources to be allocated through the cooperative interaction of millions explains why there is constant pressure to substitute political decision-making for market decision-making. Groups with narrow focuses are able to promote their advantages at the expense of the general interest through political influence precisely because the political process is much inferior to the market at promoting honest communication and motivating concern for the interests of others.

By its very nature political rationing relies on coercion. With either taxation or regulation, resources are removed from private control through force or threat of force and put to politically determined uses. People generally want the political process to be responsive to the

(Cont. on p. 10)

Regulatory Watch

DEPARTMENT OF AGRICULTURE

Several prominent congressional Republicans, the American Farm Bureau Federation, the National Grange, and the National Association of Wheat Growers are now among the groups pressuring the Department of Agriculture to adopt a comprehensive paid acreage set-aside program which would subsidize farmers for not growing crops. Advocates of such a program claim it would actually save the federal government money since it would obviate the need for future subsidies. Agriculture Secretary John Block has already instituted such a program for the wheat crop has a deadline of November 15 to decide for all other crops.

The wheat set-aside program is expected to take up to a fifth of America's wheat land out of production in order to bolster sagging wheat prices and reduce the mounting glut of grain on American markets. Under Block's plan, farmers must set aside 20% of the land they have used for wheat in order to be eligible for federal income-support payments and loans. The USDA will even offer half of this support payment in advance as an additional incentive for farmers to cooperate. USDA officials have estimated that the advance payments may amount to as much as \$400 million by September and will take at least 6-10 million acres of wheat out of production.

The USDA has also taken other action to help America's ailing grain industry, including an additional \$300 million in guaranteed loans to grain purchasers. All of the loans offered will be tied to wheat or other grain transactions. This action will raise available USDA credit to approximately \$2.8 billion.

The USDA has amended Farmers Home Administration regulations to provide variable interest rates for water and waste disposal and community facility loans which would depend upon the median income of the families in the service area. Under previous regulations, lower interest rates were offered only to communities with median family incomes below the poverty line. The new rules now provide for the construction of a sliding scale of interest rates.

The Agriculture Marketing Service has proposed changing regulations involving the grading and certification of meats and meat products by changing the basis by which fees are collected on legal holidays. The purpose is to make the charges for federal grading and certification services "more equitable" without imposing additional costs on anyone in the meat industry. Under current rules, meat and meat product establishments do not have to pay fees for federal meat inspection and grading services on legal holidays because such services do not operate. Under the proposed change, these fees would be assessed on an hourly basis if the store is open, even if the meat grader's services are not available.

USDA's Food Safety and Inspection Service has proposed rules that would implement the provisions of the Agriculture and Food Act of 1981 and the Federal Meat Inspection Act. The proposed rules would require that all meat and meat product imports be subjected to health and safety standards in the country of origin that are at least equal to USDA standards for domestic products. These standards must cover inspection, sanitation, quality, species verification, and residue tests. ■

Competition and Cooperation (Cont. from p. 9)

benefits and costs that political decisions convey to and impose on the public. However, this requires some means of effective communication. In a democracy citizens are able to communicate with each other and with their elected representatives by voting and lobbying. Unfortunately, this communication process is crude at best and completely misleading and dishonest at worst.

The broadest range of public opinion is communicated through voting. By becoming informed on political issues and the positions of different candidates on

these issues, each citizen is able to vote for those whom he thinks will best represent his interests. To the extent that voters do stay informed and vote accordingly, politicians, who are interested in maintaining the advantages of political office will be motivated to remain responsive to the broad interests of their constituents. However, one problem is that individuals have little motivation to be broadly informed on political issues.

In contrast to a market choice where the individual's decisions control the outcome as it affects him, each indi-

vidual knows it is unlikely that his political decisions will have any influence on the final outcome. Not surprisingly, people will devote more time and effort to becoming informed on their market purchases than on their political "purchases." Almost everyone realizes that decisions about national security are more important than a personal decision on the purchase of a used car. Yet almost everyone will spend more time informing themselves on the alternatives when deciding on a used car than on determining an appropriate foreign policy. This rational ignorance and apathy in political decision-making leaves politicians with little information on public preferences and makes it easier to ignore with impunity much of the information they do receive from voters.

This is not to imply that everyone will be politically uninformed and apathetic. Many government programs, expenditures, and protections provide significant benefits to narrowly focused interest groups. Agricultural price supports, import restrictions on shoes, and loan guarantees for Chrysler are but a few of many examples. Members of such interest groups have a strong motivation to become politically informed and involved for the purpose of protecting and, whenever possible, expanding their particular programs. Because of their common occupational concerns these groups will generally be organized and will find it relatively easy to confront and influence key political decision-makers.

Of course, these special interest programs will impose costs on the general public in the form of higher taxes, higher prices, and general economic inefficiency. But organizing the general public for the purpose of generating political opposition to special interest programs is extremely difficult. The cost of a wasteful government program to any one individual is often negligible. Even if not negligible, the cost is seldom large enough to motivate an individual citizen to spend time and effort resisting a special interest program even if such resistance was sure to be effective. The moti-

vation to resist almost vanishes completely when the previously discussed impotency of the individual in the political process is considered. So when a program is being considered that benefits the few at the expense of the many, our political representatives can expect to hear from the few, but not from the many. The political bias toward excessive government taxation, expenditure, and control is not hard to understand.

Most of us would be willing to sacrifice many of the benefits we receive from our favored government programs if we would be sure that everyone else would do the same. But this does not happen because, in contrast to market communication, the ability to communicate through the political process is extremely limited. Without the incentives provided by private property and exchange, the political process is unable to motivate people to communicate their preferences to each other in such a way as to insure honesty and mutual concern.

Dishonesty and Divisiveness

When engaging in political communication, making exaggerated claims and grossly distorting the truth are effective ways of advancing one's interests. Since the benefits captured through political competition will be paid for primarily by others, there are strong incentives to exaggerate the advantages that a favored government program will provide. For example, when the Audubon Society is politically communicating its concern over federally owned wilderness land, we hear that allowing any development on this land will result in completely unacceptable and irreversible damage to our priceless natural heritage and will impose enormous costs on the current and all future generations. Yet when the Audubon Society owns wilderness land, as it does in the case of the Rainey Wildlife Sanctuary in Louisiana, it allows an oil company to exploit natural gas reserves in the sanctuary in return for a mutually agreed upon payment.² If the Audubon Society prevents development of its privately owned land, it sacrifices the value, in terms of forgone

revenue, of the development potential of the land. Therefore, there is no motivation to exaggerate the damage developers would do. Rather, the interests of the Audubon Society are best served by assessing carefully the damage from development and communicating honestly its willingness to allow development to occur as long as the value that results exceeds the costs.

Political communication not only fails dismally to reward honesty, it also does little to motivate concern for the interests of others. Indeed, quite the opposite is the case. The dynamics of political communication often lead to the polarization of issues and disruptive social conflict. As opposed to success in the marketplace, political advantages are seldom realized by openly and honestly acknowledging one's interest in personal gain. Success in the political process requires that private advantage be disguised behind the rhetoric of social concern and fairness. Those political interest groups that are most adept at characterizing the policies they favor as fair and those they oppose as unfair, will be the most successful in the competition for political influence.

This means that political competition tends to pit one view of social justice against another. Issues soon become clashes over principles, with neither side willing to compromise. The desire of each side to overcome the political apathy of potential supporters reinforces the tendency for political decision-making to become collisions between opposing moral imperatives. Because the connection between individual effort and return is a tenuous one in the political arena, it is difficult to arouse the troops to political action. People simply do not become politically involved over the possibility of realizing incremental increases in commonplace advantages. Noble causes and high emotions energize the political process. The greatest political advantage is realized by communication that sets the stage for all-or-none outcomes and minimizes the potential for compromise.³

The more things we attempt to decide upon collectively, the more social malice and animosity will be generated. Extensive collective action is the surest way to destroy productive and cooperative social interaction. ■

¹Though product misrepresentation will never be completely eliminated, it is greatly mitigated by market forces. Market arrangements develop that reduce the gains from fraud because both buyers and sellers benefit from such arrangements. See Ben Klein and Keith Leffler, "The Role of Market Forces in Assuring Contractual Performance," *Journal of Political Economy*, August 1981, pp. 615-41.

²See John Baden and Richard Stroup, "Saving the Wilderness: A Radical Proposal," *Reason*, July 1981, pp. 28-36.

³For more on this theme see, Dwight R. Lee, *The Political Economy of Social Conflict, or Malice in Plunderland* (Los Angeles: International Institute for Economic Research, 1982).

GOVERNMENT SPENDING MONITOR

A quarterly feature of *Policy Report*, the "Government Spending Monitor" summarizes the latest expenditures by the federal government.

EXPENDITURES (annual rate
in billions of \$)

	1982 2nd Quarter	1982 1st Quarter	1981 4th Quarter	Average for Last Year
Federal Government	725.5	664.4	781.6	708.2
Defense	187.5	176.3	176.5	176.3
Labor	32.7	32.0	23.4	28.7
Education	13.5	14.2	16.4	14.4
Health and Human Services	251.5	193.7	299.6	247.6
HUD	16.1	13.0	16.0	14.1
Energy	8.5	8.3	7.6	9.3
Transportation	12.2	18.8	20.2	15.9
Federal Aid to State and Local Governments	83.1	82.9	82.9	84.9
Federal Interest Paid	134.1	101.1	125.4	113.3
Federal Transfer Payments	311.6	302.4	297.2	301.2
Federal Surplus or Deficit	-10.0	-94.8	-192.8	-83.0
Reported Federal Debt (at close of quarter)	1079.6	1066.4	1028.7	1044.7
Total Government Employ- ment, All Levels (millions)	16.1	16.2	16.1	15.9

SOURCE: Monthly Treasury Statement of Receipts and Outlays of the United States Government.

PR Reviews

The Ultimate Resource, by Julian Simon. Princeton University Press, 1981. 415 pp. \$14.50.

The publication of this excellent volume marks an important step toward discrediting the modern doomsayers who predict the imminent decline or destruction of Western civilization. Fears of overpopulation, ecological catastrophe, and resource scarcity are well known.

It's often been said that a little price theory can go a long way, and *The Ultimate Resource* is good evidence of this. Simon points out that such doomsday scenarios as the Club of Rome report, *Limits to Growth*, ignore the elementary laws of supply and demand. While we all recognize that physical resources are scarce, if supplies threaten to become depleted their price will rise — a fact ignored by the report. Rising prices will create incentives to switch to substitutes, conserve and reclaim existing supplies, and search for new sources of supply.

The bulk of this book is devoted to an analysis of the economics of population — hence the title, which refers to creative human energy and labor. It is convincingly argued that neither the world as a whole nor Third-World nations suffer from overpopulation problems. ■

"To be governed . . ."

Next they'll be demanding good service

"The free enterprise system has created chaos in the trucking industry," said [Joe F.] Gilbert, who is president of the Staunton, Virginia-based trucking giant [Smith's Transfer Corp.] "Before deregulation, we didn't have cut-throat rate making. We've had recessions before, but we never used to have to cut prices just to keep our customers."

—*Washington Post*, July 6, 1982

The things they go through for us

Two [congressional candidates] had the wherewithal and the commitment to public service to loan their campaigns more than \$400,000.

One was Texas Democrat William Patman, the son of the fiery populist Wright Patman, who loaned his campaign precisely \$495,593.15. The other was farmer, engineer, state legislator, and Iowa Republican Cooper Evans, who chipped in \$440,000. Asked whether the joy of serving in the House turned out to be worth this large personal investment, Evans answers quickly: "It isn't a matter of joy for me. I'll tell you, there isn't much joy here. It's a demanding and debilitating job. It's not a matter of pleasure, but of public service."

—*Harper's*, July 1982

We're afraid she's probably right
Meetings of Maryland's Harford County Council might attract more spectators if the newest candidate for the council presidency wins her election bid. . . .

[Susan] Avery is better known locally as the Susan of Susan's Go-Go Club, who both manages and performs. . . .

Her political qualifications? "I don't feel," she said, "that I'm any worse than any of the other candidates."

—*Washington Post*, July 30, 1982

Guidance, yes, but never control

Emery is flatly wrong in saying that [Alexander] Hamilton wanted "heavy regulation and control" of business by government. He advocated encouragement, even guidance, of the structure of development via fiscal policies, but never regulation and control.

—*Business Week*, July 12, 1982

Higher? How about any standard?

It is Congress's reluctance to hold its own members to a standard higher than the Criminal Code that infuriates many critics. In the clubby atmosphere of Capitol Hill, misbehavior is generally tolerated or handled with a figurative wrist slapping. Of the 10,957 people who have served since the first Congress convened

in 1789, just one has been expelled for corruption.

—*U.S. News & World Report*, July 9, 1982

Don't change the policy,
change the numbers

[Treasury Under Secretary Beryl] Sprinkel blames stubborn interest rates on the Fed's tolerance of sharp fluctuations in money supply growth. Last week the board voted to change its accounting to try to smooth money supply movements.

—*New York Times*, July 4, 1982

65 bad harvests in a row — a new record

Plagued by mercurial weather, the Soviet Union appears to be heading toward its fourth bad grain harvest in succession.

—*Washington Post*, July 29, 1982

Without USDA no one would grow food

[Agriculture Secretary John Block's] speeches and interviews are laden with a central thought: let free markets work, get government out of agriculture, and farmers will be in clover.

Trouble is, Block's critics like to say, that ain't the way the world turns. Agricultural markets aren't free . . . agriculture couldn't exist without government programs.

—*Washington Post*, July 5, 1982

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