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Are Tax Cuts Inflationary?

by David I. Meiselman

The following paper was presented as testimony before the Congressional Joint Economic Committee. Dr. Meiselman, Secretary and Treasurer of ICEPS, is Professor of Economics and Director of the Graduate Economics Program at the Virginia Polytechnic Institute and State University.

There is widespread agreement on the desirability, indeed, necessity for reduced inflation, lower interest rates and more economic growth. Moreover, there is also a growing consensus that taxes are too high and that many federal government spending programs either return too little for the costs involved or are inappropriate altogether.

Despite general agreement that slowing inflation is crucial to improve equity and economic performance, there is still much disagreement among informed, public spirited citizens and public officials of good will how to slow inflation, and similarly, what effects tax and budget cuts will have on inflation, interest rates and economic growth.

The relationship between tax cuts and inflation appears to be one of the most misunderstood in current public policy discussions. The connections between tax cuts and inflation, and tax cuts and interest rates, also seem to be misunderstood and misinterpreted by financial markets. Most of what we hear about the presumed connections between reducing tax rates and the effects of the rate reductions on inflation and on interest rates is simply wrong. In many respects, the flawed analyses stem from applying an invalid Keynesian theory which overlooks both the central role of monetary policy in the inflation drama as well as the impact of taxes on output.

Inflation

Inflation occurs when the quantity of money expands faster than output. This relationship may well be the most extensively tested

proposition in all of economics, with few, if any, exceptions. The quantity of money controls aggregate demand, and there is a close connection between the nominal stock of money and nominal gross national product, which is the best measure of total spending. Output, aggregate supply, depends on other factors, such as available inputs of labor, capital, raw materials, and the state of technology as well as the incentives to put them to efficient use.

Let me first deal with output, the supply side of the central relationship explaining inflation. Changes in tax rates, or other provisions of the tax code, will affect inflation if these changes alter output. Tax increases that penalize saving and investment or discourage work result in lower output and thereby in higher prices. It makes no difference whether such tax increases are explicitly legislated by Congress or whether effective tax rates are implicitly enacted by money-induced inflation which pushes individuals into higher tax brackets or causes businesses to pay taxes on fictitious profits that result from the requirements of mandated historic cost accounting.

Because different tax changes may have different impacts on output, one should not lump together all tax increases or decreases. Instead, careful analysis of the effects of proposed tax changes on output is essential. In the past,

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- Economist Thomas Sowell reports on the history and consequences of government interference with the economic life of ethnic and racial groups.
- An exclusive interview with George Stigler, the economists' economist from Chicago.
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Tax Cuts

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and to this day, most tax analysis is flawed because it focuses on presumed aggregate demand effects and largely ignores supply. Tax rate reductions that lessen the disincentive effects of the tax system will cause output to increase. For a given stock of money, more output results in lower prices. Thus, supply-enhancing tax cuts lead to lower prices.

Interest Rates

As supply-enhancing tax cuts lead to lower prices, so, too, do lower prices lead to lower market interest rates. For example, consider some of what follows from adoption of faster depreciation. Initially, some businesses may pay less tax to the Federal government. Business cash flow rises, and before anything else takes place, Treasury receipts fall. Treasury borrowings rise, but these are fully offset by reduced business borrowing. Interest rates, momentarily, stay the same.

But, because there is now more incentive for capital formation, business will invest more and produce more. Increased output will make prices lower than they would have been otherwise. The inflation premium component of market interest rates will then decline, and this will cause interest rates to fall. The increased post-tax rate of return on business investment will lead to an increase in real or inflation-adjusted interest rates. Because the inflation premium is by far the major factor in current record-high interest rates, it is likely that market rates would end up lower and real rates would end up higher as a result of the faster capital recovery provisions.

Savings

Increased output and increased real income will provide some of the savings to finance the capital expansion. In addition, and perhaps no less important, higher post-tax returns will also induce more saving.

Of course, another way of increasing post-tax returns on saving further is to reduce marginal tax rates. At the present time, the post-tax return on saving for many, if not most of us is negative. Small wonder we save and invest so little and why most families have abandoned financial markets for rug dealers and diamond merchants to provide for their futures or to protect capital. Lower nominal interest rates and higher post-tax real rates would not only involve more saving, but more saving would be channeled into financial markets and thereby to private capital formation. This is also the prescription for battered financial markets, and for so many of our endangered financial institutions. This is also why I support tax reduction on personal as well as business income and assets.

The Keynesian Response

The Keynesian theorists ignore the supply consequences of tax changes and associate tax increases with reduced aggregate demand, and thereby lower prices. Similarly, Keynesian analysts associate tax reductions with increased aggregate demand, and thereby higher prices. Despite widespread belief in these Keynesian assertions, there is essentially no evidence to support them, especially when the effects of money and output are taken into account.

I have run a series of statistical tests to see if, after making allowances for money and output, there was any discernable or dependable relationship between changes in tax rates and inflation. I found little evidence to indicate that such a relationship did exist. To the best of my knowledge, many other researchers have come to similar conclusions. This should not be surprising, given the close relationship between money per unit of output and the price level.

I will spare you the agonies of facing correlation and regression statistics at this point. Suffice to note that in examining the relationship between prices on the one hand and the ratio of real high employment revenues to po-

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tential real G.N.P. as a measure of tax rate shifts, I found a weak but *positive* connection between tax rates and inflation. That is to say, higher tax rates seem to be associated with higher prices!

I may add that there is some evidence that Federal government expenditures have an independent impact on inflation. Thus, budget reductions would help to slow inflation.

Effect of Deficit On Inflation

Along the same lines, I also examined the degree to which the deficit affected inflation. When public debt is introduced as a separate variable, we do see a small and statistically significant impact on the price level. However, the effects are so small it is clear that the deficit is a minor actor in the inflation drama.

Federal Reserve

Even though the deficit *per se* may not be the crucial factor in inflation, the way the deficit is financed is central to any understanding of the inflation process. If a deficit is financed by selling government bonds to the Federal Reserve, the resulting increase in the supply of money reduces the value of money, which is to say, inflation results. Alternatively, if the deficit is financed by selling bonds to the public, no such inflationary increase in money takes place. To be sure, real interest rates may rise in order to induce the public to buy the additional bonds. But unless there is an increase in inflation, this rise in interest rates is bound to be small. The major factor in high and rising interest rates is the large inflation premium which is built into all interest rates at the present time. Thus, any attempt to lower interest rates by simply printing new money to buy additions to the national debt ends up by causing higher inflation, which, in turn, causes interest rates to rise, not fall.

Many believe that deficits somehow cause the Federal Reserve to increase the money supply. Deficits are seen as placing some great "burden" on the Federal Reserve. To lighten this "burden," the Federal Reserve creates some money and buys bonds.

The Federal Reserve is not required by law to monetize the deficit. Indeed, the spirit of the law explicitly prohibits the Federal Reserve from doing so; witness the restrictions on direct sales of debt by the Treasury to the Federal Reserve. Of course, the loophole is that the Federal Reserve can buy outstanding debt rather than new debt. Because there is essentially no difference between new bonds and old bonds, the results of buying old debt are the same as monetizing new debt. Bank reserves and the monetary base increase. Money expands. Infla-

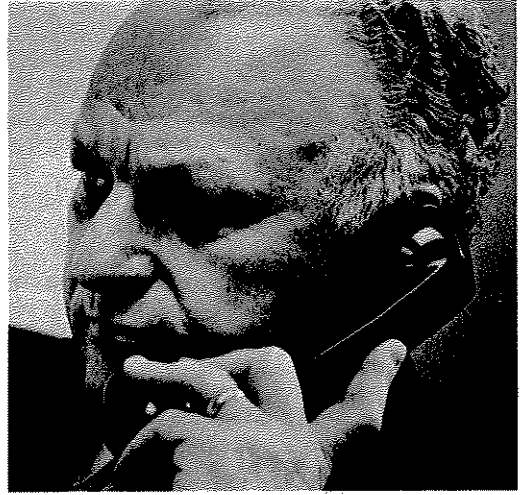


Photo by Craig Terry

David I. Meiselman

tion results. Instead of interest rates being lower, interest rates end up higher. Indeed, this suggests that the Congressional mandate to the Federal Reserve should essentially be: "Don't just do something. Stand there!"

Summary

There is certainly an important and legitimate role for taxes in the financing of needed government services. If more resources are to be channeled into the public sector, higher taxes depress private sector activity, thereby freeing resources and making them available for the public sector. However, it would seem that tax rates have become so high—more because of bracket creep than explicit legislation by Congress—that the private sector is too depressed for our own good. Moreover, the depressive effects of high and rising tax rates have differentially depressed capital formation and risk taking more than consumption and reduced work effort more than leisure.

High taxes have worked all too well in curtailing private sector activity. Instead, we need a reduction in taxes, especially those taxes that discourage investment, saving, risk taking and work.

High taxes do not reduce prices and do not fight inflation. High taxes do reduce output, employment and economic growth. It is time to stop punishing ourselves in the hope that pain itself will cure our problems. Masochism is not the remedy. Budget cuts, tax cuts that lessen disincentives, regulatory reform, and above all, a slow and stable rate of growth of money are the necessary components and the cure for our serious inflation and high interest rate ills. □

Government and Minorities: A Reduction of Options

by Thomas Sowell

"In discussions of ethnic groups and their economic conditions," Thomas Sowell writes in the forthcoming ICEPS book Markets and Minorities, "... problems arise when people do not distinguish between axiomatic assertions and testable hypotheses." This distinction has often been overlooked by academicians less interested in testing hypotheses than in holding on to standards consistent with their own ideologies. Nothing so irritates this type of ideologue than the scholar who applies logical methods of testing to rhetorical "axioms." This being so, Markets and Minorities contains much to infuriate the ideologue.

Thomas Sowell has never let ideologies interfere with his commitment to the academic testing ground. This is especially true when he applies the tools of the economic trade to public policy issues involving race or ethnicity. Markets and Minorities deals with some particularly "touchy" issues, but this makes Sowell even more determined to subject these issues to the rigors of economic analysis. As Sowell states in his opening chapter, "It is often taken as axiomatic that adverse intentions (racism, prejudice) are solely responsible for adverse results. An economic analysis must treat this as a testable hypothesis."

A Senior Fellow in Economics at the Hoover Institute, Sowell is on leave from his teaching post at U.C.L.A. and has recently stepped out of the limelight to concentrate on his research. This Fall, however, Prof. Sowell will be the featured participant at an ICEPS conference timed to coincide with the publication of Markets and Minorities.

Government has three roles in the economy that bear on the economic fate of ethnic groups: (1) government provides a legal framework within which transactors can make their own economic (and other) decisions; (2) government can reduce the options available to the transactors; and (3) government can redistribute the fruits of economic transactions. In the following discussion, we deal with the second of these three roles: Government reduction of options.

Economic analysis would lead us to expect that people would more fully satisfy their own respective preferences with a larger set of options, where the larger set includes all the items in a smaller set. Yet there are many government laws, regulations, and policies whose effect is simply to reduce existing options without adding any new ones. Minimum wage laws, rent control, and interest rate ceilings, for example, simply outlaw certain ranges of transactions terms. Housing codes, occupational licensing laws or Jim Crow laws have made certain kinds of trans-

actions illegal, regardless of their terms. None of these laws and policies add any options. They simply remove some existing options.

Housing

In housing, such government programs as "slum clearance" or urban renewal have been justified by studies showing former slum-dwellers living in "better" housing. But this is no new option. Slumdwellers always had the option of moving into better housing, at the sacrifice of some non-housing goods they were purchasing. All that "slum clearance" has done is force them to make a trade-off they did not want to make—i.e., to become worse off by their own preference standards.

In special circumstances, the negative effects of some transactions on non-transacting parties may justify option-reduction applied to transactors—precisely in order that the excluded preferences of non-transactors be taken into account. Air and water pollution are classic examples of these external effects. In such cases, there is no net reduction of options of all the affected parties, even though the options of the immediate transactors may be reduced. Housing has sometimes been alleged to be another cause of external effects, as in the proposition that "slums breed crime."

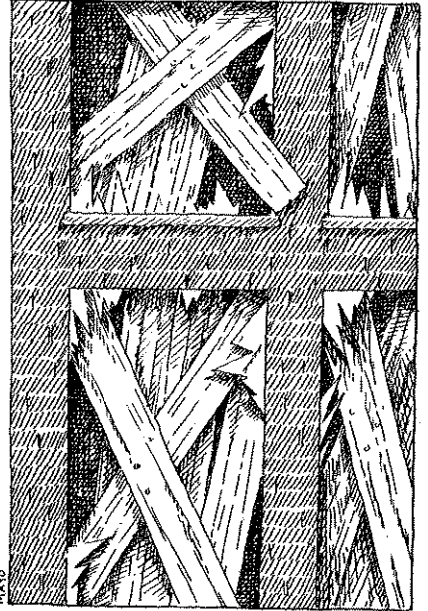
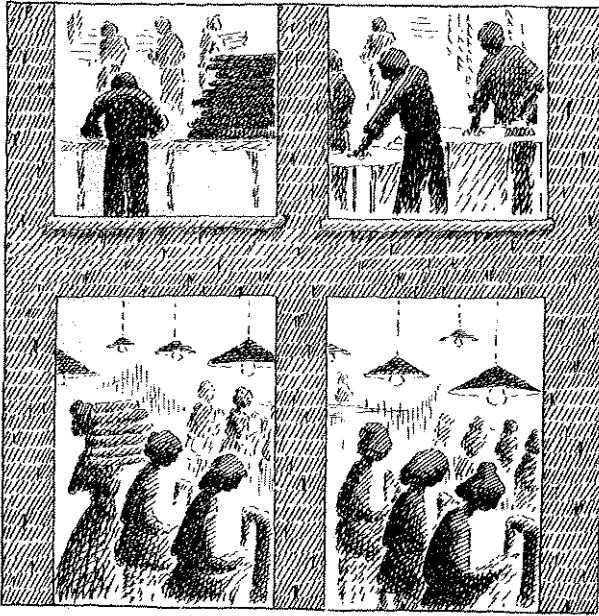
As the proportion of physically substandard housing units declined in the 1960's, the crime rates soared. New York's Chinatown was once one of the lowest crime rate sections of the city, despite older and more rundown buildings than in Harlem. The later crime increase in New York's Chinatown—and Chinatowns in other cities—was not associated with housing deterioration but with the arrival of new Chinese immigrants from a different culture in Hong Kong.

The central role of people and their values—rather than physical surroundings—raises the question of whether much of the physical deterioration is not itself a result of the same set of values, or lack of values. Brand new government housing projects around the country have become instant slums as former slum-dwellers moved in. All the characteristics of old-fashioned slums—filth, noise, violence, and physical destruction of property—have reappeared in government housing projects. Even such a zealous 19th century reformer as Jacob Riis, who called slums "nurseries of crime," also noted that some people "carry their slums with them wherever they go."

Labor

In labor markets as well as in housing markets, government reduces options in general—

There are many government laws, regulations, and policies whose effect is simply to reduce existing options without adding any new ones.



and the options of low-income ethnic groups in particular. In 19th century American cities the lowest jobs, as well as the worst slum housing, belonged almost exclusively to the various immigrant groups from Europe. On the West Coast, such jobs and such housing was also the fate of immigrants from China, and in the South it was the fate of newly freed blacks.

Government regulation of labor markets has included occupational licensing laws, minimum wage laws, regulation of working conditions, and child labor laws. It has also been demonstrated that minimum wage laws reduce the price of discrimination, thereby increasing the quantity. Such laws also harm low-income ethnic groups in their role as less skilled or less productive workers for whatever reason (inexperience, cultural patterns at variance with industrial requirements of punctuality, discipline, cooperation, etc.). Restrictive occupational licensing laws also reduce the employer's cost of discrimination by creating a surplus of job applicants. In addition, occupational licensing standards may themselves be discriminatory. For example, during the 1930s, when many skilled Jewish refugees were entering the United States, a U.S. citizenship requirement was added to most occupational licensure laws. In the South, around the turn of the century, licensing examinations for black plumbers were conducted by white examiners, who almost invariably "failed" them, even though the same individual blacks easily met the requirements elsewhere. With the rise of government-supported labor unions having complete dominance over particular occupations—notably in the railroads and the con-

struction trades—union membership was tantamount to occupational licensing, and was used to keep out (or drive out) blacks.

In both the craft union situation and in explicit occupational licensing, it was the turning over of governmental powers to private interests that was the key to the effectiveness of the exclusion. Occupational licensing boards are almost invariably in the hands of existing practitioners. With the Wagner Act in 1935, the government made employer recognition of existing employees' unions mandatory, and therefore put into the hands of incumbent workers the power to exclude other workers.

Government control of working conditions would seem to be racially or ethnically neutral, but historically its impact has been quite different for different groups, regardless of whether or not this was the intent. In the 19th century, the prime target of government regulation of working conditions was the "sweatshop" where long hours in rundown buildings was the rule. These sweatshop workers were almost entirely immigrants, and the classic example were the sweatshops among the Jewish workers on the lower east side of New York. Again, the government did nothing to directly create better conditions—that would have cost vast sums of money—but instead simply outlawed some existing conditions, or reduced the options open to the transactors. One of the other options was to have the work performed in the home, where it was more difficult for government inspectors to monitor hours or working conditions.

A contemporary account of a typical 19th

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Government and Minorities

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century east-side tenement mentioned, along with "smells of cabbage, onions, of frying fish" on every floor, also "whirring sewing machines behind closed doors, betraying what goes on within..." The men, women and children—mostly Jewish in this era—worked long hours in their homes. But although reformers and historians have spoken of this as "exploitation," they also acknowledged that (1) the sweatshop owners themselves made little money, despite long hours of work, and (2) among the Jewish workers on New York's lower east side, the long hours were hardly necessary to keep body and soul together, despite their low pay, more than half of which reportedly went into the bank. In short, despite the sinister innuendoes and indignant language which have become standard in describing this situation, the actual evidence suggests nothing more than employers and employees making the most of such limited options as they had, given the technology, skill, and wealth at their disposal. Government added to none of these three requisites, but only reduced their ability to optimize according to their own knowledge and preferences. In view of the later economic progress of Jews, it is by no means clear that their understanding of their situation was not at least as good as that of the reformers, who tried vainly to stop them from doing what they felt they had to do.

Education

Nor is it obvious that the greater success of 20th century reformers in forcing contemporary low-income minority youths out of the labor force has been a blessing, especially given the evidence of correlation between youth unemployment and crime. These reform efforts have included not only control of working conditions, but also compulsory school attendance laws which make full-time work illegal for those of school age. Here, at least, the claim can be made that the government adds to the available options by providing schooling free of charge to the users. However, the forced retention of teenagers who do not want to be in school is hardly costless to the other students, or to the process of education. A study of changes in the compulsory attendance law in Britain showed that the oldest group retained in school had the highest delinquency rate, both before and after that age was raised—thirteen year olds before, and fourteen year olds after. It was apparently not the fact of being age thirteen or fourteen that was crucial—it was the length of time being forcibly retained past the point where the process had become counterproductive for both the student and the school.

It is often taken as axiomatic that more years in school is "a good thing"—virtually without limit, in defiance of the economic logic of diminishing returns and of inherent trade-offs between one good and another. But, once the idea of trade-off is accepted, it is easy to understand that the terms of trade-off may differ from individual to individual and from group to group, implying that different amount of schooling may be optimal in different circumstances. Moreover, those closest to the situation—the parents and children—may have more knowledge of their options than distant social theorists. But when the decision as to length of schooling is made by third-party observers and enforced by government, it is more likely to reflect some crude compromise between what the poor prefer and what the middle class prefer—very much like "decent housing."

Insofar as such reform efforts are spearheaded by the educated, and by educators—and seconded by labor unions, with a vested interest in restricting the labor supply—the tendency of compulsory attendance laws is to keep youths in school well past the point where they and their parents would have preferred that they be working. Evidence for this hypothesis includes both high rates of truancy and in-school delinquency in low income ethnic neighborhoods—much more than in past periods, when the school-leaving age was lower.

Conclusion

The many instances in which laws, regulations, and other governmental restrictions have produced economically detrimental results for various ethnic groups does not necessarily imply any special ineptness or depravity on the part of government officials. In many cases, the intention has been to benefit ethnic groups considered to need aid or protection. But even in those cases where the intention has been to thwart the advance of particular ethnic groups—the Chinese or Japanese, for example—these efforts have also largely failed.

Repeatedly ineffective or counterproductive actions—from minimum wage laws to housing regulations—suggest inherent limitations on what government can achieve. These have generally been limitations of knowledge rather than power. Even totalitarian states have had similarly counterproductive effects from their economic regulations.

Economic analysis offers no way to make human beings morally better, kinder or more tolerant toward those different from themselves. What it does offer is insight into the way different economic institutions affect the well-being of human beings as they are. □

MARKET FORUM

MR Interviews George Stigler

Earlier this Spring, MR Associate Editor Tom Hazlett conducted an interview with one of the giants in the field of contemporary economics, George Stigler. Prof. Stigler, as the following interview attests, is bullish on the University of Chicago's Department of Economics. Past reputation alone is enough to justify that bullishness. Former students and associates of Prof. Stigler at Chicago include Milton Friedman, David Meiselman, Thomas Sowell and many other brilliant economists. Unlike many of his associates, Prof. Stigler has avoided "going public" in order to devote all his time to continued academic research. This interview was conducted in his office at the University of Chicago.

This is the first part of a two-part interview.

Tom Hazlett—I want to start off with the theme of your talk yesterday. Your first point was that consumers do not benefit by government regulation in the economy.

George Stigler—except in circumstances that are not very common.

H—Rent control in New York, for instance.

S—And some kinds of so-called externalities like the pollution problem.

H—First of all, just to narrow down rent control in New York, you're referring to benefits for a very small segment.

S—That's right. Indeed, it doesn't even benefit modern tenants. They either have to somehow buy access to the sheltered (rent-controlled) place or search long and hard to find some other quarters. It's the original tenants who take over part of the property rights of the landlord.

H—Right. So, if the consumers do not benefit from such legislation—

S—Some benefit. Obviously those with sheltered rents benefit.

H—But your point, then, is that the real reason we have regulation is because certain business interests do benefit from regulation.

S—The larger part of it comes from the supplier side, and I said that I thought that business was the biggest of the supplier groups to get regulation, but I wouldn't exempt farmers—which you might call business—and labor unions and occupational crafts and things like that.

H—Is this system terribly inefficient?

S—Moderately inefficient, yes.

H—How much wealthier would we be if King George Stigler was on the throne?

S—Well, putting aside the macabre thought that it might destroy the nation, I made a wild guess in my talk yesterday of a 10 to 20 percent gain in national income. But the plain fact is, nobody knows. Nobody's done the work. And, in particu-

lar, Murray Wiedenbaum's wild estimates aren't of any value in this respect.

H—Now, your conclusion is that consumers are getting hurt but business in general is reluctant to give up the special advantages because of this "free-rider problem," let's call it.

S—That's part of it. You see, part of it is that if I give mine up, I still get stuck by all the others. That's the free rider problem. But there's also the fact that if you eliminated all of them, the common argument is made that all business would then be ahead. That's *undemonstrated*, and I assume the contrary—that some businesses are better off, even in this maze of mutual regulation and retardation, than they would be in a completely free economy. Not all. The society as a whole would naturally have larger income, but I'm not prepared to assert that everybody is worse off by this inefficient regulatory system, though the optimists say that.

H—You might think it has something to do with the individual personalities of the business leaders and the entrepreneurs that are now influential in the system.

S—My Chicago view tells that they're all out "maximizing" economic performance and that while some may be smarter than others and do a little better job and be more imaginative and innovative, I don't have them being whimsical in matters of this importance.

H—No, I refer to the selection process that is going to weed out the people who might be more, let's call it, "market-oriented."

S—Well, it's certainly true that if I were picking a head of General Motors, there was a time I would have said, 'How good is he at producing great automobiles at low cost?' I like that, but now I would also want him to be pretty clever at dealing with Congress and the Administration.

H—Okay. So your conclusion is that, since business isn't going to give up its special privileges and the consumers are going to get

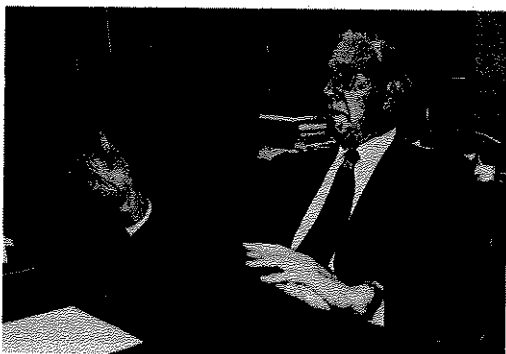


Photo by David Asman

Professor George Stigler

George Stigler

hurt, that we shouldn't be too worried about the situation and let's not get riled up about it.

S—Here I have a puzzle. I don't think the world is inevitable. And I think it is possible to find kinds of political changes which will inhibit regulation without simultaneously reducing some other kinds of liberties that we want to have. You know, it would be very easy to get rid of most economic legislation of this sort by requiring it to be passed in two consecutive Congresses by 90 percent of the vote. I think that would take care of most regulatory policies. But that would take care of a lot of other policies I don't want to take care of, so to speak, you see. So the problem is—can we devise political institutions which somehow inform the average citizen more? See, it doesn't pay them to be well informed now. Inform him more on what the costs of these programs are and how to combat them.

H—You're talking about political lobbying.

S—That's right. And we haven't devised fully effective or even partially effective systems to deal with that. If we can get better ones, I would expect some regulation would diminish. By the way, I expect some regulation to diminish anyway. The airlines, for example, had reached the stage where a substantial number of them were no longer gaining by the regulatory system and saw the other option as favorable.

H—So, what is your conclusion then? You think that there are only moderate chances for reform of the regulatory system.

S—Well, I think before we invent any new political institutions—it'll be nice if we do—but before that there are other things we can do. For example, here's the oil industry, and it's got this much clout so it'll get this much money. Regulators seldom ask the question: "What's the most efficient way to give them that amount of money?" Sometimes we could have invented better methods—better in the sense that there is less cost put on others. For example, around 1970, before the oil crisis, we had this cabinet report on oil imports. It was argued that the quota system should probably be abolished. But would it be?

H—Quotas were keeping the imports down?

S—Yes, that's right. And at the same time we had a domestic oil allotment system that the Texas Railway Commission was running. Now, I have said that it would be much more efficient to give anybody who has clout—like the domestic oil wells and the domestic refineries—certificates and let them get the oil where they want and not say these oil wells have to go 18 days a month and so much can come in from abroad. If we could have widened the options, while still

holding the value of these tickets constant, we would have had a more efficient method of producing oil.

H—Because the lowest cost producers would have been producing whatever the amount was.

S—And as a rough estimate, the dead weight cost of the program—which was around two billion out of five—would have been reduced substantially. Now, that's the kind of thing I think is a technical economic problem. I think we can deal with that. As for the rest, it's okay to do what Friedman does and what I've done much of my time—go around and preach to people: "Give it up; it's for the good of the nation." But you know what we've learned by these two hundred years of tariff history and things like that—it doesn't work.

H—Appealing to patriotic duty is simply useless?

S—At the cost of substantial personal sacrifice, that's right. I don't think that'll work.

H—So you don't seem to be all that excited, then, about the fact that there are tremendous inefficiencies in the present system?

S—Well, be careful. What am I going to do about something I can't change? Should I get excited about the fact that the Rocky Mountains increase the cost of transportation out to the Pacific coast? Should I say, dammit, that's a cruel fate that's been thrust upon us? Similarly here, if I've got a political system—and it works the same way in other countries as it does here—that's got this sort of accommodation to particular, well-organized groups, what am I supposed to do about it? My teacher Frank Knight used to say, "Anything that is inevitable is ideal." And while that's a kind of a paradox, it has an element of truth in it.

H—Well, I'm sure that a lot of people were quite surprised at your remarks yesterday because, as a long outspoken critic of regulation in addition to being the leading scholar in the field, it's interesting to hear George Stigler say, "This is a terrible situation. But do not worry about it."

S—Well, that's all right. The plain fact is that why should I lament something that I haven't got any constructive suggestions for? Unless you consider it constructive for me to say, let's not even dream of import quotas on automobiles, and let's abolish this regulation and that regulation. I can go around being a Don Quixote and riding my ideal society. But in some ways that seems to me to be a luxury that I should deny myself.

H—Now, you sound remarkably parallel to Lester Thurow's argument in *Zero-Sum Society*. The fact that reform within the current system almost seems impossible because for any effi-

"Some businesses are better off, even in this maze of mutual regulation and retardation, than they would be in a completely free economy."

ciency-creating measure, there is going to be some group that will fight to the death, more or less, to keep its special advantage.

S—Here I back up a little. We do work on two things here in Chicago. One is: What are the effects of regulation? And the other is: What brings them about? On the whole, we're doing pretty well on the effects. People like Sam Peltzman are developing extremely ingenious and insightful methods of dealing with regulatory policies.

On the other hand, on why we have the laws, it's a headache. We've done very poorly on that. And most of the time we've failed. And indeed, if you read Sam Peltzman's paper (which just came out) on the growth of government, that's less convincing and less clear by far than the effects of policies. So, I don't really feel that we ought to be very confident. I think Thurow was very confident about what can be done and what can't be done—what determines the regulatory levels and the like. But I don't feel that dogmatic on the political process. I've gotten more curious about it than dogmatic.

H—Has Ronald Reagan saved capitalism?

S—I don't know. I think a substantial reduction in governmental expenditures may be one of the most efficient ways to constrain things. And even though many of the regulatory policies, by the way, sidestep the budget, still, I'm delighted with the boldness of the reductions. And I'm enormously impressed with this man I've never met—Mr. Stockman. I don't expect Reagan to be as good as Carter was on deregulation. It seems to me that there's already been enough commitments to the Teamsters so that maybe the Interstate Commerce Commission won't go well, and they're not going to be rough with the Securities and Exchange Commission. They may crack down on the Federal Trade Commission, which is fine. But I'll wait and see even how much they do to the Clean Air Act and things like that. I expect we're going to have more industry regulation probably in the next four years. That's not anti-Republican. But we might have less environmental regulation—less of OSHA.

H—So where the interest is anti-business, in general, you expect a reduction. But where the business interests are at work, for instance in the ICC or the SEC, you don't expect a reduction.

S—I don't expect that to change.

H—Now what about the Federal Communications Commission. I know that's something you're personally interested in because you mention that you're a bit upset about the fact that you haven't been able to get opera on commercial television because of the restrictions for a number of years. It looked very good there for

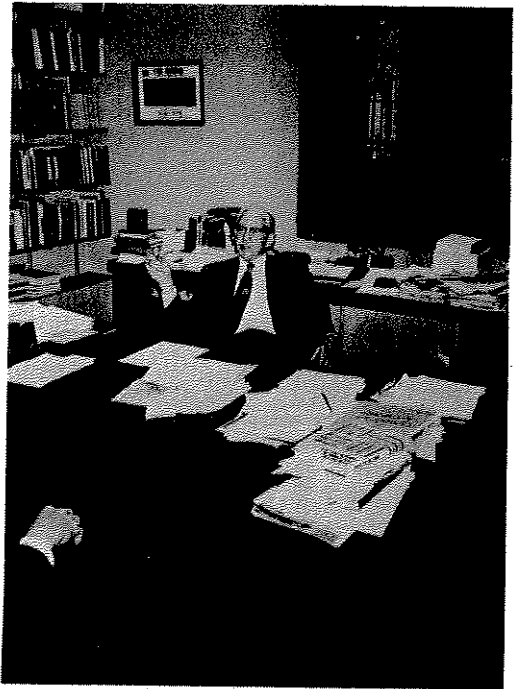


Photo by David Asman

a while. It looked like an Alfred Kahn type of self-destruct that the FCC was doing, but now has this turned around?

S—Well, I think it's more of a threat. I haven't followed the recent developments. But one or two people told me that the new moves in appointments and the like seem to make it much more industry conscious again. It (the deregulation) was going full scale for a while, but it seems to me that it's slowing. We'll have to wait for another six months and see. But I don't expect that to continue as strongly, at least in that direction.

H—What do you think about the supply-side theology of the new Reagan administration?

S—My objection to it is that it seems to me in a certain sense both sound and misdirected. I think removing inhibitions on production is fine, although that runs into all the regulatory obstacles that you run into. I'd be delighted with the reduction and the constraints upon efficiency. I don't think it has much to do with inflation. And if it weren't for the economic fact and results of throwing more goods against the same number of dollars, why, I'd say it was fine. But I think it's a shallow theory of inflation, and I don't have any confidence in that side at all.

H—So inflation is only going to be solved by putting the reins on—

S—On fiscal and monetary policy, yes. □

Continued in next edition of MR

PERSPECTIVE On Deregulation

Since 1973, radio stations in America have been forced to comply with a Federal Communications Commission (FCC) regulation that they devote a specific amount of air time to what the Commissioners defined as "public affairs" programming. Such programming ranged from government-produced advertisements for Social Security and legal-aid services to in-depth analyses of issues and events. When the Commission rescinded this requirement, effective as of April 1, 1981, ICEPS found itself in the classic position of an organization that, while strongly opposed to regulation on philosophical grounds, nonetheless benefitted from it in terms of the market place in which it operated.

Our own public affairs radio program, PERSPECTIVE ON THE ECONOMY was, we believed, undoubtedly being used by many stations merely to fulfill their FCC requirements, and naturally we felt some stations would drop our program once those requirements were lifted. Indeed, several stations whose motivation for airing the series was minimal compliance with the regulation did just that. But, as inevitably happens in the case where markets are deregulated, products which provide a genuine service to the consumer flourish while those whose existence depended on regulatory "protection" are driven out. We are happy to report that PERSPECTIVE ON THE ECONOMY has passed the market test.

Program Director Roby Scott of station KDB in Santa Barbara, California, whose enthusiasm for PERSPECTIVE has not wavered, reports: "Now that the FCC is lifting our public affairs requirements, we are dropping many of the PA spots. But we'll be keeping PERSPECTIVE ON THE ECONOMY. There's nothing like it on the market!"

What makes PERSPECTIVE stand out from other public affairs programming? "Your program is really unique in that you provide the listener with an authoritative view—one they can trust," says General Manager William Howell of WGXM in Dayton, Ohio. Bill Breland

of WXTG in Charleston, South Carolina also picked up PERSPECTIVE because of its authoritativeness: "When you're speaking to a radio audience, you can't just be some guy with an axe to grind; your credentials have to look pretty good, and you have to tell the audience something they don't already know."

Like many program directors today, Breland recognizes the audience-building potential of public affairs offerings: "People want to hear information from responsible sources." Breland had no qualm with the FCC mandate as a programming constraint. "Our biggest headache with the FCC over PA broadcasting," he told *MR*, "was the paperwork we had to supply them with to prove we were playing PA programs. It's enough when you have to keep up with your own paperwork, but we were being forced to provide them with two years' worth of daily programming schedules. It was a disaster." Other station managers around the country agree with Breland. J.R. "Buck" Buckley, station manager at WIBX in Utica, New York, is an enthusiastic proponent of the voluntary approach: "My 'bread and butter' is public affairs programming," he recently told *MR*, "I use it to reach a wider audience."

The prospects for PERSPECTIVE during the coming year are encouraging. We recently revamped the program, expanding our group of commentators to twelve regular members. Some of these analysts are key economic advisors to the Administration in Washington—an added bonus in promoting the show. Some of the success in promoting PERSPECTIVE has, in fact, been the result of publicity generated by our commentators themselves. One station in Seattle found out about the program through an announcement in *Reason* magazine, whose editor, Robert Poole, is one of our regular commentators. The PERSPECTIVE network does indeed stretch across the country.

So, it appears that once again the decentralized market place has proven itself to be the best judge of what consumers want and need.

Can't Afford to Save

by George Gilder
Program Director, ICEPS

Remember the days when it paid to save? Everyone's dream was to make a lot of money, put it in the bank, and live comfortably off the interest. At the very least, one could hope to make a modest return on money put away for a rainy day. Today, savings is a washout. But President Reagan's

tax cuts could change that.

To understand the impact of a tax cut on savings, we should recognize that each marginal tax rate in a progressive system inflicts a double penalty on saving. A particular marginal tax first deters the worker from earning the additional money that he is likely to save. (After all, why should he work harder for a raise when his higher salary will push him into a higher tax bracket?) Secondly, it deters him from

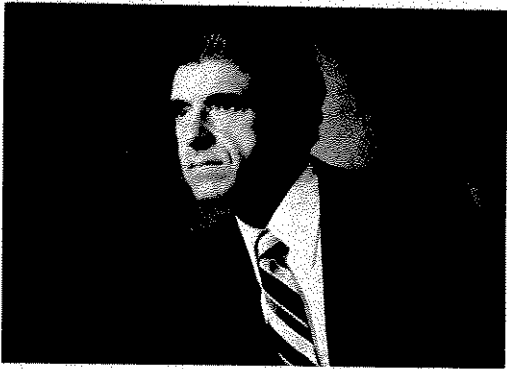
saving by taxing the interest on savings at the highest rates.

Because high marginal rates work a double inhibition on savings, cuts in these rates impart a double stimulus to savings. If the tax cuts work their way through the U.S. Congress without being hacked to pieces, it won't be long before we all begin to gain from saving.

(Continued on page 12)

ICEPS's Board of Directors

In April, Joseph F. Alibrandi was elected to the Board of Directors of ICEPS. Mr. Alibrandi is President and Chief Executive Officer of Whitaker Corporation, a Los Angeles based diversified company with 1980 revenues of over \$1 billion. He is, in addition to being an extremely busy businessman, an ardent supporter of the free market and an articulate spokesman for intelligent economic policies. An important contributor to Milton Friedman's public television series, "Free to Choose," Mr. Alibrandi first became interested in ICEPS when he learned it was sponsoring a study by Professor Thomas Sowell, whose work Alibrandi greatly admires.



Joseph F. Alibrandi

In addition to Mr. Alibrandi, the ICEPS twelve-member board includes the following: Charles F. Brunie, (Chairman), whose philosophical commitment to freedom goes back many years to his involvement with Ayn Rand's Objectivist group in New York City. Mr. Brunie is Chairman of Oppenheimer Capital Corporation and is a member of the Mont Pelerin Society. A. Wright Elliott, who joined the board in 1980, is a Senior Vice President at Chase Manhattan Bank who previously served as Executive Vice President at the National Association of Manufacturers. He heads Chase's Public Affairs Depart-



Photo by Craig Terry

Charles Brunie



ICEPS's President Bill Hammett (L) with Peter Grace.

ment and has been actively involved with a number of public policy institutes over the years. Ed Feulner is a founding member of the board, whose accomplishments as President of the Heritage Foundation are well known to readers of *MR*. Another founding member is Antony Fisher, one of the most dedicated champions of the market economy today and also founder of England's prestigious Institute for Economic Affairs. Peter Grace, of W.R. Grace Company, is a sterling example of a successful businessman who recognizes the importance of ideas. His company's economic research department has played a key role in promoting economic understanding among the nation's opinion leaders, and Mr. Grace himself directs a considerable part of his time and energy to that cause. Lewis Lehrman, the charismatic entrepreneur behind the Rite Aid Corporation, brings to the board experience gained as founder and President of the Lehrman Institute, a public policy research institute, which has worked closely with ICEPS in the past. Professor David Meiselman of Virginia Polytechnic Institute, another founding member, is a familiar name in academic circles and is rapidly gaining stature as a policy analyst (see page 5 of this issue). A leading proponent of the monetarist school of economics, Dr. Meiselman's judgment and counsel have been of inestimable value to ICEPS's development. Randy Richardson, a leading philanthropist and student of public policy, plays an active role on the ICEPS board and brings to it a remarkable degree of experience in business and research. Dr. Joel Segal, President of Baruch College in New York, an accomplished economist and administrator, has been a member of the board since 1979 and is a source of much assistance. William E. Simon needs no introduction; he is simply the most dedicated and articulate spokesman for economic freedom in America today. Robert Stuart, our "Midwestern" representative on the board, takes time out from his busy schedule as Chairman of National Can Company in Chicago to help direct the affairs of ICEPS and rounds out what we consider to be a most impressive group of individuals. □

ICEPS REPORT PERSPECTIVE

(Continued from page 10)

Budget Cuts

by **Richard B. McKenzie**
*Professor of Economics
Clemson University*

A great deal has been written about President Reagan's proposed cuts in federal expenditures and taxes. People are sincerely concerned that the expenditure cuts will actually reduce programs designed to benefit the needy—that President Reagan plans to chop away at the size of government. The proposed tax cuts are thought, by many, to be inflationary.

Granted, President Reagan has recommended that taxes be reduced by some \$54 billion and that government spending be reduced by around \$48 billion. Those that fear government will shrivel into never-never land can rest easy. First, the Reagan Administration is not likely to get from Congress all that it has requested. Second, due to what is called

"bracket creep," inflation will, over time, gradually push up government spending and push people into higher and higher tax brackets. Seventy-five to eighty-five percent of Reagan's so-called tax cut will be erased by bracket creep by 1984.

Third, and finally, the proposed reductions in expenditures and taxes are not cuts in this year's budget, but in next year's budget—the one proposed by the Carter Administration.

Law of the Sea

by **Robert Poole**
*Editor-in-Chief
Reason Magazine*

After this country's sad experience with OPEC, you'd think people would have learned their lesson. Not our politicians and bureaucrats. Along comes a plan to set up a new cartel—this one in strategic minerals—and our leaders have been falling all over themselves in support of it.

The minerals in question are manganese nodules on the ocean floor, rich in nickel, cobalt, copper, and manganese—all vital minerals for which we depend on imports. The new cartel would be set up under the UN Law of the Sea Treaty. This treaty sets forth the idea that seabed minerals belong to all mankind—instead of to whoever discovers each particular deposit. In practice, that means they would belong to a UN cartel, which would control all seabed mining for the benefit of the Third World, with decisions being made on a one-nation/one vote basis.

Incredibly, the seabed treaty was endorsed by our last four presidents, Republican and Democrat alike. Only the new Reagan Administration has even questioned whether we need a floating OPEC.

We do need a law of the sea. But the purpose of law is to protect people's rights—including the rights of those who discover and mine seabed minerals.

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