Pathfinder

CENTER FOR EDUCATION AND RESEARCH IN FREE ENTERPRISE
TEXAS A&M UNIVERSITY COLLEGE STATION, TEXAS 77843

June 1988 Volume 10, Number 4

WHAT THE COUNTRY NEEDS IS MORE DISCIPLINE, LESS TALK ABOUT A TAX HIKE

Have budget deficits put our country on the road to ruin? Much public discussion makes it seem that the country is either on the brink of a calamity or headed toward one. Whether the complaint was high interest rates and a strong dollar in 1983 and 1984 or a falling dollar in 1986 and 1987, the budget deficit gets blamed. After the dramatic fall in stock prices in October, "everyone" seemed to agree that the most important thing to do was to reduce the budget deficit.

Everyone except the experts, that is. When academic experts talk about the deficit these days, there is often lively discussion about recent theoretical work showing that the deficit has no effect on output, employment, spending or interest rates.

A deficit, according to this theory, is just a decision to tax sometime in the future instead of now. What matters is the government's spending, not the decision to pay with today's taxes instead of tomorrow's.

Many economists, trained to believe that deficits are important, find the argument wildly implausible.

They point out that there are many possible reasons why the abstract and general argument may be formally correct but inapplicable to an economy like our own.

A great many efforts to show how wrong the argument is have turned up much less than the investigators expected, however. If deficits and debt have had important effects on interest rates or investment, researchers have not found them. The effects that have been found in the most careful studies seem tenuous, not calamitous.

Further, the experts agree that the size of recent budget deficits is overstated by as much as $65 billion. A main reason for the overstatement lies with the recording of interest payments on the national debt. These payments include a return to the lenders of the losses they expect from future inflation. The losses to the lenders are gains to the government. The government counts the interest it pays but it fails to count the gains, or receipts, from inflation.

Nevertheless, the proponents of gloom maintain, we have allowed the national debt to double in this decade. Two and one-half trillion dollars of government debt seems large. The U.S. economy produces $4.5 trillion of output, however, so the gross government debt is currently about 50 percent of a year's output. This is less than many other countries, including countries such as Japan and Italy (90 percent) or Austria, Britain, Sweden and Holland with debt between 55 percent and 70 percent of total output. None of these countries is on the verge of high inflation. The risk of inflation cannot be put aside entirely. A large debt and continuing large deficits raise the risk of inflation. Recently, we have seen this experience repeated in Brazil, Argentina, Bolivia, Israel and elsewhere.

The German hyperinflation of the 1920s reminds everyone that money can become worthless and savings in bonds, savings accounts and insurance can be wiped out.

In each of these experiences with high inflation, deficits were financed by printing money.

If our government decided to finance continuing deficits with substantially higher money growth, the risk of inflation would rise. The Federal Reserve would run the printing press and use the money to buy up the debt, just as the central banks did in Bolivia, Brazil and other high-inflation countries. Once started, the temptation to continue inflating would be hard to resist.

To reduce the risk of inflation and other possible consequences of the budget deficit, we should bring the budget toward balance. By now, everyone has seen that Congress is unwilling to reduce spending and the President is properly hesistant to raise taxes. Is there a way out that doesn't require cuts in spending or increases in tax rates that the political process cannot, or does not, deliver?

The surprising answer is yes. If we are patient and ignore those who, in this election year, would make the deficit into a crisis waiting to happen, we

Continued on next page

From page one

can reduce the deficit without raising tax rates or reducing the real level of spending. By the end of the next presidential term, we can be close to balance, possibly even have a small surplus.

This is not just "pie in the sky." The economy has been growing at about 7 percent a year; 2 percent to 3 percent is real growth and about 4 percent is inflation. If taxes remain at the average rates of the fall of 1987 and spending rises at the 4 percent inflation rate, the budget will have a surplus at the end of 1992. (Tax reform lowers individual taxes but raises corporate tax rates, so the net effect leaves the average tax rate about the same.) There is even room for a slight increase in spending to raise Social Security payments faster than inflation.

This modest program brings us close to a balanced budget by the end of the next presidential term without raising taxes. And, if we correct the government's accounting for interest payments, the budget is in surplus by 1990, just two years from now.

The point of this exercise is not to set a blueprint for balancing the budget or to argue that it is painless to bring the budget into balance. The moral is that we don't have to treat the budget problem as a crisis. We do have to discipline ourselves enough to hold down the *growth* of spending for a few years.

This seems an appropriate solution. The long sequence of budget deficits is the result mainly of letting spending grow faster than taxes and output. For 37 years, since 1951, taxes have grown at about the same rate as output and incomes.

Each administration has taken between 18 percent and 19 percent of national output in taxes, on average, during its term of office. To date, the Reagan Administration is on the high side of the range, despite the tax cuts and tax reforms passed in 1981 and 1986.

Growth of spending tells a different story. Since the 1960s, government spending, including interest payments, has risen faster than output. The string of budget deficits is the result.

By keeping the growth of spending below the growth of output, we can balance the budget without raising tax rates or cutting the real size of programs that, rightly or wrongly, Congress and the public seem unwilling to reduce. It will help the voters to keep that firmly fixed in mind in this election year when candidates eager to raise taxes try to convince voters that there is no other way to avoid calamity.

—Allan H. Meltzer
J. M. Olin Professor
of Political Economy and Public Policy,
Carnegie Mellon University

The article was prepared for the Los Angeles Times.

NEWS FROM THE SOVIET UNION

SUGAR SHORTAGE

More sugar has been sold this year than usual, largely because of demand from purchasers pouring in from other towns. The solution? Order the shops to sell sugar only early in the morning and late in the evening, on the assumption that this will frustrate those who travel in from deficit areas. But the real problem, of course, is the expanding amount of samogon (moonshine) under production because of the restrictions on vodka sales.

Izvestiya, March 18, 1988

COBBLERS WITHOUT BOOTS

Petrol stations regularly run dry, especially at the end of each quarter. In Kaluga, for example, there has been no petrol for three weeks, says *Izvestiya* (November 28, 1987).

At Irkutsk airport, some 15 airliners and several transport aircraft were stuck to the ground as if frozen, while hundreds of passengers camped in the airport buildings. Irkutsk received some 6,000 metric tons of fuel less than planned, and had to supply many extra flights. But this was not exceptional, according to *Pravda* (November 25, 1987), because a similar situation prevailed at Bratsk, Chita and Krasnoyarsk, while Ulan-Ude was also running short. Thousands of passengers were stranded for days on end. It takes five days for fuel to reach Irkutsk from the refinery at Omsk—yet there is another petrochemical complex much nearer at Angarsk.

DEATH PENALTY UNDER ATTACK

"Several dozen women fell victim to a certain Mikhasevich, who committed his crimes in the period from 1971 to 1984, but was not exposed until 1985. Yet, by then, 14 of his vile acts were ascribed by the investigative organs to other people. Innocent people confessed and suffered harsh penalties: one of them was shot. Now they have all been rehabilitated, and Mikhasevich was convicted . . . . " (*Literaturnaya Gazeta,* November 18, 1987).

AID TO NICARAGUA

The U.S.S.R. signed an agreement with the Nicaraguan government to supply $294 million of economic aid for the next three years and 300,000 metric tons of crude oil each year.

OFFICIAL FRAMED

Pravda (January 20, 1988) revealed that KGB officials in Odessa framed a police chief to silence him. A.V. Malyshev was head of a unit investigating the theft of state property, and was wrongly imprisoned for two years. The Odessa party chief, A. P. Nochevkin, was disciplined.

LIES COMMON IN CONGRESS

Let's eavesdrop on a conversation between a struggling married couple: "Honey, we have to start thinking about putting away money for Sally's college education. Last year we earned $45,000 and spent $50,000. This year we'll earn $55,000, so let's spend $52,000, and put the other $3,000 away for her education. This should make you happy; you'll have $2,000 more to spend this year on household expenses."

"Thanks for the budget proposal, Tom," says the wife. "Let me review it, and I'll get back to you in a couple of days."

A few days later, after heavy thought and debate with the kids, Shelia announces, "Since you're so interested in spending cuts, here's my plan: I had planned to spend $65,000 this year, but the budget I'm submitting calls for only $60,000 in spending."

Outraged, Tom shouts, "Didn't I say we had to cut spending?" "Calm down," Shelia scolds, "I've cut spending 33 percent." "What on earth do you mean?" says Tom. "Look, stupid," she replies, "I had planned to increase spending $15,000, but the budget resolution I'm submitting for your signature calls for only a $10,000 increase. In my book that's a bone-wrenching 33 percent spending cut!"

Does this scenario seem stupid, devious, and/or dishonest? Well, don't be too shocked. It's standard practice in Washington, as is illustrated in an essay by Richard Fink, president of Citizens for a Sound Economy, a Washington-based think tank.

For example, if President Reagan's budget calls for a 4 percent increase in a certain program, and Congress' current services budget (programmed wishes) calls for a 9 percent increase, then Reagan's proposed increase is called a 5 percent cut. And the same type of chicanery operates on the tax side. If the president's budget calls for a 3 percent tax increase and the Congress' current services budget says taxes ought to increase 10 percent, Reagan's 3 percent tax increase is reported out as a 7 percent tax cut.

These tactics amount to nothing less than bald-faced lying, cheating and deception by a vote-buying Congress hungry for our money. Those tactics help explain the 1988 budget agreement recently negotiated between the White House and Congress. Your congressman will tell you the deficit has been reduced by $13 billion and that an $8 billion sale of government assets makes up the difference. Citizens for a Sound Economy reveals the truth: 1988 spending will rise nearly $60 billion; taxes will increase $50 billion, and the deficit will jump $5 billion.

I don't know how we can get Congress to be honest with us. As Mark Twain observed, "There is no distinctly native American criminal class, except Congress." I wonder whether the House and Senate chaplains ever preach sermons to Congress against lying, cheating and deception.

—Walter E. Williams
Professor of Economics
George Mason University

Reprinted with permission from Heritage Features Syndicate.

INTERVIEW WITH THE CENTER'S NEWEST DIRECTOR

Jay Harris, editor of the Lubbock, Texas, *Avalanche Journal* and *Evening Journal* is the newest member of the Center for Free Enterprise board of directors. Harris is a graduate of Texas Tech University with a degree in journalism and majors in history and political science. He paid his way through college by working for the *Avalanche Journal*. After military service, Harris became managing editor of the paper in 1946. At that time, he was the youngest managing editor of a major newspaper in the United States. He was executive editor from 1965 until 1972 when the papers were sold to Morris Communications Corp. He has been editor since that time.

When they married, Harris' wife thought she was marrying a future foreign correspondent—his ambition in college—and that they would live all over the world, but they never left Lubbock. The Harrises began their world travels in 1975, and since that time they have been to the Middle East, South Africa, the Orient, the Soviet Union, Europe, and Latin America many times. They write articles and columns—Mrs. Harris is a free-lance writer—about the geopolitical situations in these countries and their relation to the United States.

Harris has long regarded Texas A&M as one of the premier institutions in the United States and among the top five or six in terms of improvements. He has supported Steve Pejovich for years.

"I have known Steve for years. He is the best at explaining free enterprise to young people. He has spoken to many student, business and civic groups in Lubbock on the importance of free enterprise to Texas and the United States. When he asked me to serve on the Center's board of directors, I was pleased to accept."

Pathfinder asked Harris for his opinion about some potential world problems and possible bright spots. The following are excerpts from some of his responses.

"Hard as it is to imagine now, we may see another energy crisis in the next five or six years. The war in the Middle East must be stopped. Disruption of oil supplies from that region would have a major impact on our allies."

"The world monetary crisis is depressing, in particular, third-world debt owed to U.S. banks. It must be recognized that much of this debt isn't going to be repaid, yet the banking system must remain viable. That will be a problem."

"The federal budget deficit must be addressed, as must the foreign trade deficit. Nonetheless, if the game is played on a level field, free trade, along with exporting our free enterprise system, is our strongest foreign policy. Take, for example, the Pacific rim countries, South Korea, Taiwan, Hong Kong, and Singapore. Twenty to 30 years ago these were feudal farming systems. Trade and free enterprise brought them political stability and living standards that are remarkable considering their standards of only a few years ago. Certainly we sent them money, but look at what we got in exchange—products for our homes and political stability over there. Contrast that with the money we have sent to other places where we got nothing but political turmoil."

"Protectionism just doesn't work. Trade might cost some jobs, but it certainly creates a lot of other jobs in the U.S."

The *Pathfinder* is pleased to have Jay Harris on the board of directors.

THE ROAD AWAY FROM SERFDOM

Although I currently serve in Congress, I regard myself as a free market economist. Yet I was not introduced to the work of great free market theorists like Ludwig von Mises or Friedrich von Hayek as an undergraduate or even as a doctoral student. Indeed, it is safe to say that *Human Action* and *The Road to Serfdom* are rarely read in American universities while books like John Kenneth Galbraith's *The Affluent Society* are widely read and discussed as if the Great Society programs it rationalized were not in total disarray today.

Why do some economic theories remain popular even when the policies and results they have wrought are under serious question? I have been acutely aware of the answer to this inquiry ever since I discovered as an academic professor that macroeconomics is typically more popular than microeconomics: Easy ideas are always more quickly accepted than hard ideas. Galbraith's ideas, which were always more like scenarios than science, made their way into our government, our schools, and our entire way of thinking because they were so easy to grasp and to explain to others.

The trouble with Galbraith's theory and, ultimately, the greatest evil of *The Affluent Society,* is his refusal, replicated by President (Lyndon) Johnson in his ill-famed guns-and-butter speech of 1965, to acknowledge this basic truth. There are no limits, no constraints, they claimed instead, so we don't have to be careful about husbanding and allocating our resources among competing ends. Today, you can witness many government policy makers in action who don't recognize even the most ordinary constraints in the way you or I would. We are all intimately involved, for example, with the principle of budget constraints, sometimes called "fiscal responsibility." If we spend more money than we earn, the check at the grocery store bounces and then our car or our house may be repossessed. We face direct and unpleasant consequences for our profligacy. Does anyone really suggest that the government fears the same?

Galbraith and many of our government representatives play upon our resentment of those richer or more successful than ourselves, a resentment articulated many years ago by Thorstein Veblen in his highly influential book, *The Theory of the Leisure Class,* which painted the upper strata of our society as indolent, self-indulgent and hoarding.

The modern redistributionists argue: "Look at the terrible shape America's in. The problems are too big for individuals to solve. Let us help." And they offer us, simply, more government—more government along Keynesian lines with many instruments of what I refer to as "government by deception," not the least of which is deficit spending, in which the true costs are hidden from the people who, of course, pay the bills, or through another instrument, corporate taxation, which is sold to the voters as if it had nothing to do with their own incomes.

Transferring the ownership of property or services back to private control on the basis of rational market decisions and clearly defined objectives is often misrepresented as robbing the government or even "the taxpayers," but nothing could be further from the truth.

Armey's Axiom Number One: The market is rational. The government is dumb. That is not merely a cliche. I used to teach an entire graduate course to reinforce such a premise. Individuals face sobering constraints every day—money, time, resources—and they do not, on the whole, make heedless decisions.

—Dick Armey, Congressman

"The Road Away from Serfdom" was originally presented during the April 1987 Ludwig von Mises Lectures at Hillsdale College.

Participants in the Center's conference on Professor F.A. Hayek's latest book on socialism.

Dr. Pejovich with interns who will be working at various Washington, D.C., think tanks this summer.

In April, the Center sponsored attendance at professional meetings by two Texas A&M faculty members. Dr. Leonardo Auernheimer, associate professor of economics, attended the CATO Institute's Conference on Trade Deficits held in Washington, D.C. From April 22-24, Dr. Leonard Bierman, associate professor of management, attended the Philadelphia Society meeting in Chicago.

— ■ —

Dr. Steve Pejovich spoke in Dallas at the U.S. Chamber of Commerce's "Free Trade Is the Way To Go" meeting in March.

Dr. Pejovich spoke at Texas A&M Muster in Palestine, Texas, on April 21.

— ■ —

In May, the Center's guest was Dr. Stephan Koren, economic advisor of the ruling conservative party in Austria. Dr. Koren and the Center's friends and supporters from the Dallas-Fort Worth area held a fruitful exchange of thoughts on the international economic situation.

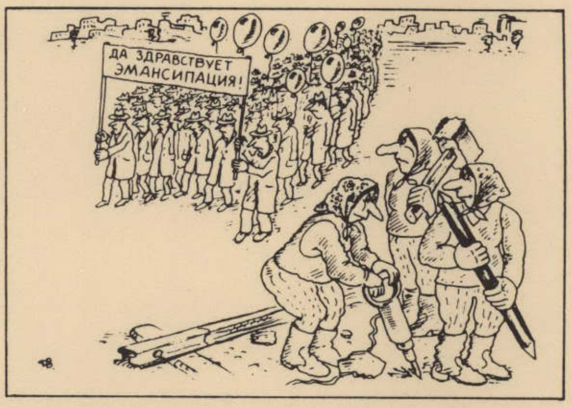
— ■ —

Dr. Pejovich was invited to attend Dr. Karl Brunner's Conference on Science and Ideology held in Switzerland in May.

— ■ —

The Center's board has named faculty members to **two professorships.** Dr. Edgar K. Browning, professor of economics, was appointed Rex Grey Professor, effective September 1, 1988. Dr. Pejovich was appointed Jeff Montgomery Professor effective immediately.

Dr. James Buchanan, Nobel laureate in economics, and Dr. Pejovich at a Center function.



***Ogonëk*, No. 51, December 1987: "Long live emanicipation!".**

PATHFINDER

Volume 10, Number 4 **June 1988**

Published six times a year by the Center for Education and Research in Free Enterprise in cooperation with Educational Information Services, Texas A&M University, College Station, TX 77843. Telephone (409) 845-7722.

Svetozar Pejovich, Director
S. Charles Maurice and Svetozar Pejovich, Editors
Sheila Amin, Publications Editor

Contributors of $5 or more receive *Pathfinder* for one year; teachers in elementary and secondary schools may receive *Pathfinder* without a donation.

SEMINAR ON ECONOMICS AND RELIGION

The Center sponsored a Seminar on Economics and Religion February 29 and March 1 in Dallas. In his letter of invitation to the participants, Dr. Steve Pejovich stated the purpose of the conference.

"It is understandable that clergy would want to expand the influence of moral doctrine beyond the norms of individual behavior. Scripture, however, simply does not address the important aspects of economics any more than it does for biology. These are complex and technical subjects with a large literature. Those who would like to improve the human condition must be familiar with economic principles. Otherwise, mistakes might be made, which could cause more harm than good. A successful implementation of public policy requires more than good intentions.

Being forced to compete in the harsh world of economic reality equips many of the laity with the ability to distinguish between what works and what does not. The fact that church leaders frequently promote policies, which the laity know will not work, creates a serious problem for both the clergy and the laity. Adopting policies that do harm cannot be justified by simply claiming that they are well-intentioned. More important, the moral authority of the clergy is eroded in the eyes of the laity when counterproductive policies are promoted."

Participants in the seminar were: Dr. Karl Brunner, Fred H. Gowen Professor of Economics, University of Rochester; Rev. Damien Fandal, Barry University; Dr. Robert Fastiggi, assistant professor of humanities, St. Edward's University; Prof. Paul Fenech, Center for Business, St. Edward's University; Dr. Paul C. Goelz, director, A. H. Meadows Center for Entrepreneur Studies, St. Mary's University.

Also, Dr. Paul Heyne, professor of economics, University of Washington; Dr. Harold Hoehner, professor of theology, Dallas Theological Seminary; Dr. James Johnston, senior economist, Amoco Corporation; Dr. Mark Jordan, professor of philosophy, University of Notre Dame; Dr. James E. Kirby, dean, Perkins School of Theology, Southern Methodist University.

Also, Dr. Leonard Liggio, president, Institute for Humane Studies, George Mason University; Dr. William H. Meckling, dean emeritus, University of Rochester; Dr. William H. Mobley, executive deputy chancellor, The Texas A&M University System; Dr. Dennis O'Brien, president, The University of Rochester; Dr. Steve Pejovich, professor of economics and director, Center for Free Enterprise, Texas A&M University.

And, Dr. Albert Pennypacker, senior minister, University Christian Church, Fort Worth; Most Rev. Michael J. Sheehan, Catholic Diocese of Lubbock; Rev. Jerold Shetler, Preston Hollow Presbyterian Church, Dallas; Rev. Robert A. Sirico, Paulist Education Center, Minneapolis; Michael Warder, executive vice president, The Rockford Institute; Dr. Kelly Williams, Chapelwood Methodist Church, Houston.

— ▪ —

AGGIES GO TO D.C.

A new program for undergraduate students at Texas A&M who have excelled in their fields was approved recently by the Center. The students, sponsored by the Center, will spend 10 weeks working in Washington, D.C., as interns at various think tanks.

This year's interns and their assignments are: Amy Couvillon, National Journalism Center; Brad Craig, Jack Brown Intern with The Heritage Foundation; Eric Fisher, Jack Brown Intern with The Heritage Foundation.

Also Brian Frederick, National Journalism Center; Mark Gee, National Journalism Center; Patricia Leech, The CATO Institute; Jennifer Lindsay, Capital Research Center; Anita van Tilburg, The CATO Institute.

NONPROFIT ORG.
U.S. POSTAGE
PAID
COLLEGE STATION,
TEXAS 77843
PERMIT NO. 215

Ms. Tamsen L. Emerson
Texas Documents Collection
North Texas State University Library
P.O. Box 5188 NT Station
Denton, TX 76203