Alan Reynolds

Depressing Stimulants

A pessimistic look at Carter's economic policy.

The Carter Administration is proposing to stimulate the economy with a tax rebate and an enormous budget deficit. But not everything that is labeled a "stimulus" will, in fact, perform as advertised.

The first problem is that federal deficits are not a source of free money. If the Treasury borrows from me and gives the proceeds to you, there is no net change in purchasing power, and your taxes will have to be higher in the future to pay interest to me. In attempting to peddle more securities, the Treasury has to make them attractive by boosting interest rates. Aspiring private borrowers have to top the offer, or drop out of the competition for a limited supply of lendable funds.

We're told that Treasury and off-budget borrowing of something like $175 billion over the next two years will present no problem, because a sluggish economy will keep private credit demands down. But we're also told that the same Treasury borrowing will end the sluggish economy, which necessarily means vigorous private borrowing for investment, inventories, housing, and consumer durables.

Well, if there isn't enough money to go around, the Fed can always print more. In fact, all of the veiled talk about "coordinating" fiscal and monetary policies just means that the added deficit is a roundabout way of pressuring the Fed into pumping out more money. The 11% increase in M2 over the past year is already enough to fuel an increase of 12-13% in nominal GNP in the coming year or two. Once any spare capacity is used up—probably within a year—the low quantity and quality of capital will keep real growth below 4%, leaving an 8-10% trend of inflation.

If the Fed increases the money supply even faster, in a futile attempt to ease the coming congestion in money markets, that will be correctly perceived as even more inflationary. The dollar will slide on foreign exchange markets, and borrowers will rush to borrow for commodity speculation and inventory accumulation—adding a higher inflation premium to interest rates, both long and short.

Yet we are continually reassured that low capacity utilization *now* will protect us from the inflationary consequences of these policies—policies that will not fully take effect until 1979 or 1980. The argument gives no guidance as to the appropriate dose of "stimulus." It would appear that the deficit and rate of money growth could safely approach infinity so long as there is high unemployment somewhere in the country. Sending more money to retired civil servants in Miami is somehow supposed to put to work the idle defense workers in San Diego, without adding to inflationary pressures in New Hampshire (where unemployment is 3%).

The Federal Reserve's index of capacity utilization in manufacturing stood at 81% in the fourth quarter—the same level as in the first quarter of 1972. Does it follow that the fiscal and monetary stimulus of 1972—which was much smaller than now—did not threaten inflation in 1973? I didn't think so at the time, and I still don't.

Besides, a lot of physical capacity has become uneconomic because of energy costs and environmental and safety regulations. Jumbo jets, for example. It would not pay to bring such capacity onstream without price increases that would surely be squelched by the price controllers. The result is that capacity in some areas and industries may be strained long before the aggregate measure reaches previous peaks—which have been around 87%, not that far from today's 81%.

So, forcing the economy to digest another $31 billion of Treasury debt in the third and fourth years of a recovery entails very real risks and costs. What are we offered in exchange for these risks and costs? A $50 installment on the McGovern $1,000 plan, another sneaky move toward the Britainization of the tax system, and some rancid lard from the empty pork barrel.

The hope of the rebates is that low-income people, armed with the windfall of an extra fifty bucks, will rush right out and buy new houses and cars—this is the "trickle up" theory. The related one-month surge in retail sales is then supposed to trick businessmen into embarking on long-term expansion of capacity. It won't work.

The bone thrown to business is too little too late. An investment tax credit provides no incentive to put existing manpower or machinery to work, it is of little value to either short- or long-term business investment, and the depressed area of nonresidential construction is not helped at all. The payroll tax credit is too tiny to affect employment decisions, and is washed out by this year's doubling of payroll taxes for unemployment insurance. And the only so-called permanent tax cut, raising the standard deduction, provides no help to those with incomes above $17,500 and is not permanent at all—it will soon be wiped out by inflation.

Congressional alternatives are even worse. Providing a tax credit for adding workers would just give employers a powerful incentive to lay off more workers in the downturns.

I certainly don't want to give the impression that I am against tax cuts. But the nature of the Carter tax cuts is all wrong. Because tax rebates are based on past earnings, for example, they provide no incentive to do something productive in order to increase present and future earnings. What we need are believably permanent reductions in tax rates, on both individuals and business, carefully targeted to increase the incentive for workers to work, for investors to invest, and for employers to employ.

The supply response would be greatest from cutting taxes where they are highest—namely, high-income families and income from investments.

The richest 5% of all families—those earning over $32,000 in 1974—had an average of 2½ family members working. They are being severely punished for their efforts. We tax work and subsidize nonwork and are surprised when unions bargain for leisure rather than wages, and when senior union members insist on the privilege of being first to be laid off. One consequence is that early retirement is getting ridiculous. Less than 5% of black males aged 45-54 were neither working nor seeking work in 1950; in 1975, the figure was 14.4%.

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Inflation has pushed more and more people into higher and higher tax brackets, and has resulted in onerous taxation of purely illusory profits—capital gains and interest earnings. In the early 1960s only about 3% of all tax returns were subject to marginal tax rates over 30%; by 1974, nearly a third of all tax returns were in those brackets. In 1966, two Brookings economists estimate, the average overall tax rate on income from capital was almost twice as high as the tax on income from labor.

The tax reforms of 1969 and 1976, combined with taxation of inflated income, have raised this punitive taxation on capital even further—thus stifling the main source of growth. We tax the stuffing out of income from investments and are surprised when nobody wants to save and invest.

Like the tax cuts of 1971 and 1975, the Carter tax cut will be heavily tilted toward those with low incomes. If these increases in the progressivity of the tax rates were done explicitly and honestly, Middle America would throw the rascals out. After the last two tax reductions, the average federal tax rate on a family of four earning $10,000 to $15,000 rose from 6.5 to 10.3%. With tax cuts like these, who needs increases?

Everyone is saying that higher natural gas bills will reduce purchasing power and increase inflation—a magnificent contradiction. Money spent on domestic gas and oil is not lost to the economy. You might just as well say that because people spent more on batteries and snow tires, the economy is faced with deflationary pressures. The idea of adjusting fiscal policy to the weather is fine tuning carried to a ridiculous extreme. Stimulating demand when supply is restricted is a way to get people to rush out and buy what isn't there; a clearly inflationary idea.

Moreover, an increase in the price of, say, citrus fruits and vegetables—which is only about 3% of the consumer price index —is not inflationary. If people pay more for one thing, they have less to spend on others, and there is no lasting inflationary effect.

Actually, the short-term outlook is quite good. It takes time, and a lot of hard work, to demolish the U.S. economy. But the new Administration has made a good start at it. □

Tom Bethell

Capitol Ideas

"My husband quotes Darwin to me all the time," said Happy. "Yeah, yeah," the Vice President perked up. "To survive you gotta adapt."

For months I found it hard to understand why Washington is so grey to the mind's eye. The weather tends to be sunny, the atmosphere clear, the surrounding countryside beautiful. I called an old Washingtonian who now lives in Hollywood and is involved in the movie business. "There are so may pastel shades here," she said. Of course. One thinks of Hollywood in color—technicolor. "Why is Washington so grey?" I asked her. She thought for a minute and said: "It's the newsprint." A beautiful perception, I think. The newspapers here are the "trades." More or less everyone in Washington has a professional obligation to read them. It is a depressing exercise. What a gloomy compilation the *Washington Post* is: an assemblage of memoranda to Congressmen and supermarket ads.

Russell Baker noted recently that to a Rip Van Winkle awakening after a 20-year sleep, "perhaps the most shocking change....would be the universal display of undressed girls on magazine covers at the newsstand where he buys his morning paper." When he finally got around to reading his paper, our Van Winkle would soon enough encounter the tremendous propaganda campaign currently underway to depict women as an abused "minority." This would have seemed absurd to him in 1957.

Somehow, these two features of the contemporary landscape are never linked up, as they should be: prominently displayed pornography, depicting women as sex objects; and the complaint by women that they are treated as sex objects.

Technology links them. Birth control pills make "sex objects" out of women. And abortion: a million unborn children murdered every year in this country. Undoubtedly the reduction of women to sex objects—the disconnection between sex and childbirth and the onanistic gazing at objects of sexual fantasy—is the most serious evil dislocating our society today. But this is unlikely to be perceived as anything other than an eccentric view, at least for some time. Women hail the Pill as "liberating." And liberals champion pornographers as free spirits exploring the boundaries of self-expression.

The prosecutions of Larry Flynt of *Hustler* and Harry Reems of "Deep Throat" have brought the Washington liberals out to the predictable fund-raisers. A sigh of happiness is heard in the city: At last! Persecution once again! Police State Repression and all that. "I have to tell you that there is something refreshing about the Reems case," wrote *Washington Post* columnist Richard Cohen. "It is such a blatant example of governmental excess that when you couple it with the return of capital punishment, it gives liberals like me something to live for."

Now we have a full-page ad in the *Post* and the *New York Times* "sponsored by Americans for a Free Press" proclaiming Larry Flynt to be AMERICAN DISSIDENT (like Solzhenitsyn). It is signed by predictable spirits of the age, among them Ramsey Clark, Pete Hamill, Daniel Ellsberg, Hugh Hefner, John Leonard, Gore Vidal.

Surely Malcolm Muggeridge was right. The behavior of our contemporary "liberal" can be explained only in terms of a death wish: Dismantle the Pentagon, the funds to be diverted to education—no doubt innovative. Take Soviet expressions of goodwill at face value. Kill off unwanted, unborn infants who have done no harm to anyone, but keep alive convicted murderers. There you have the liberal agenda for the 1970s.

Back in the days of Batista, the winter months were the season for travel to Havana. They still are today. Only the sponsor has changed, from Batista to Fidel. It is now very "in" in Washington to fly to Cuba for a week, preferably in the party of a senator or

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