VIEWPOINT

The Recovery They Love to Hate

BY JAMES ROLPH EDWARDS

You'd think everyone would have been happy about the economic expansion experienced this past year. But if anything has been more surprising than the recovery's strength and apparent endurance, it has been the associated attitudes of the news media and the economic analysts whose views they report. Never has a healthy economic expansion been accompanied by such constant expressions of trepidation and anguish! Nightly we have been told that "economists" fear that rising interest rates resulting from excessively rapid growth will choke off the recovery.

Now consider the logic here: Rapid growth makes interest rates rise; higher interest rates reduce growth; so we should have slower growth to prevent the higher interest rates that reduce growth! It is perhaps significant that this bizarre argument is always attributed to *unnamed* economic analysts. I, too, would be reluctant to have my name attached to such reasoning.

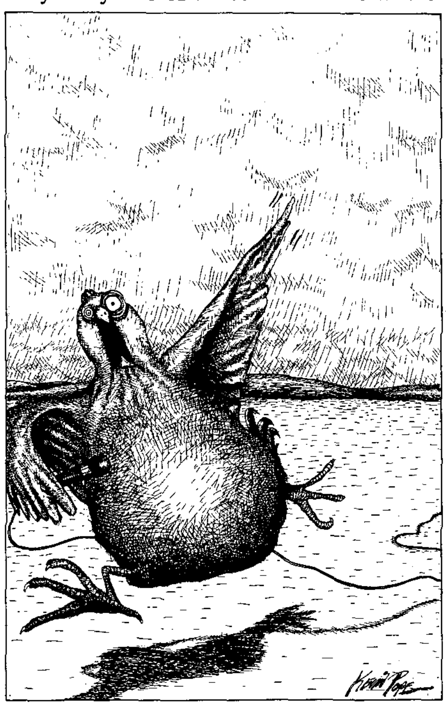
Even the basic assumption of the argument can be shown to be false. Economic growth does indeed lead to higher interest rates as businesses seek loans to expand operations. But interest rates that rise *because* of increased credit demand attributable *to* economic growth must necessarily be associated with *increased* (not decreased) credit extended—and hence must increase, not reduce, economic growth.

This is demonstrably what has happened. Interest rates on financial instruments began rising in May 1983 and continued through July of this year. The prime rate (the rate charged by banks to their largest customers) began rising in August 1983. But business loans, rather than falling, started increasing rapidly in October 1983.

By the fall of 1984, evidence of slower growth was emerging (greeted with euphoria in the media). But this was *not* because the expansion made interest rates rise. The amount of credit extended would decline (resulting in a recession) only if interest rates increased because of a reduction in the *supply* of credit. That is usually a consequence of action by the government, via the Federal Reserve, to severely reduce the rate of growth of the money stock.

Some of the confusion and misinterpretation of the current expansion may be a legitimate result of its unusual character. All previous post–Korean war recoveries have been *demand-side* expansions. In each case the Federal Reserve had caused the prior recession by reducing money-stock growth (to fight inflation). But then, under pressure to cure the resulting unemployment, the Fed responded with rapid expansion of the money stock, increasing the demand for goods, services, and labor—and inducing another round of inflation.

Of course, none of this was ever necessary. Any one of those recessions would



have ended *without* the Fed undertaking rapid monetary growth. If the rate of growth of the money stock was kept low and steady, the inflation rate would sooner or later fall below it.

This would take a little longer than it does for the Fed to "inflate" the economy out of a recession. If it had been done once, however, and inflation had thus been controlled, the whole series of subsequent contractions and expansions would have been avoided (with the exception of the OPEC-induced recession of 1974).

One of the things that is different about the current expansion is that we may have done exactly what could have been done earlier. During the recent contraction, the Fed kept monetary growth low for so long, in the face of massive pressure to reverse course, that people became convinced that for once it *really* meant to control inflation. Inflation and the rate of expected *future* inflation (and hence interest rates leading up to the expansion itself) all fell.

The second thing that is different about this recovery is that it is a *supply-side*, not a demand-side, expansion. Alterations in the growth of the money stock can only cause temporary fluctuations in the growth rates of output and employment around their trends. To increase the trends themselves it is necessary to increase the incentives people have to work, save, and invest in productive equipment. And the best way to do *that* is to lower tax rates on the income earned from such activities.

Liberals who opposed supply-side from the outset have tried to portray the expansion as being led by consumer spending, rather than supply-side factors. But in fact savings are up, and consumption spending as a *proportion* of disposable income is down.

Investment spending also tells a supply-side tale. Personal consumer spending rose at a 4.6 percent annual rate in the first quarter of 1984 and at a 6.9 percent rate in the second. But at the same time capital spending by business was soaring at a 20 percent annual rate. Meanwhile, productivity is up, and the rate of new-business formation and job creation in the last year have been the highest in decades.

The most surprising aspects of this expansion, such as the unexpectedly high growth rates of GNP (10.1 percent per annum in the first quarter, 7.5 in the second) and the persistently low inflation rates, are best explained by its supply-shift character. And that also explains why the reporting of all this good news has, in the liberal media, been characterized by palpable fear and loathing. For the supply-side vision accords individuals a lot more economic freedom than liberals are wont to concede.

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Illustration by Kevin Pope

Low-Tax Recipes

BY TIMOTHY CONDON

All right, everybody—it's the end of the year. If (to paraphrase George Gilder in *The Spirit of Enterprise*) you haven't twisted your tax affairs into low-calorie pretzels to feed to the IRS, it's not *too* late. You see, every tax specialist will rant and rave at length about doing your tax planning beginning in June or July. But since we're not all little IRS-accountant automatons, no one except those with *lots* to lose pays any attention to tax matters each year until it's almost too late. Like right now.

But fear not. Here are some special recipes guaranteed to help you put the federal government on a leaner diet.

First of all, if you've got a regular tax-jock who does your taxes each year, call him up *right now* and make him give you an hour or two of his time to talk about last-minute tax angles. He'll be far more efficient than you could be if you were working on your own. Second, tax-helper or no, take a good long look at your over-all financial situation for the year. Have you made some big-ticket purchases that will result in big tax savings, such as depreciation write-offs and investment credits? If so, you may want to *put off* some of your tax dodges until next year, since you're already shifted into a lower tax bracket.

On the other hand, how was your income picture during 1984? Did both you and your spouse double or triple your income this year? You may want to pull every trick in the tax books. But wait! Did you rake in hundreds of thousands of bucks in 1983, only to find the largesse dry up in 1984? In that case, you might want to save your bag of tax tricks for next year, when your income will doubtless be even higher than it was in 1983.

So what do you do when you find that you're going to get socked with a big tax bill next April 15? Above all, don't go baying off after any questionable tax shelters. Good, solid, aggressive tax shelters with aggressive promoters who will be around to defend their babies, yes. The kind of shelters that give Robert Dole an Excedrin headache because they *work*, yes. But *not* the fly-by-night outfits that will cost you a bundle when the IRS clamps down on them and everyone who invested in them. How to tell the difference between wheat and chaff? Ask someone in the tax and investment business whom you know is good. Usually someone with one of the big brokerage houses or big accounting firms can give a realistic assessment.

If you own your own business, you should have either a tax advisor or an accountant you can talk to. Go to him or her, pay well for advice at this late date (and deduct the cost), then do what you're told, immediately, and very definitely before December 31. This may mean things like postponing income through various devices or spending big these last few weeks on necessary equipment or machinery, not to mention all those repairs you've been putting off on your business property and equipment. Then there are write-offs for your business—old inventory and bad debts can be taken off the books, resulting in tax savings. Don't forget shifting compensation around, with bonuses (or the lack of them), stock-option plans, 401-K (deferred compensation) plans, and your pension programs. Don't overlook other expenses that can be paid quickly and will benefit you into the next year.

If you're one of the rest of us—those who don't own our own businesses—here are some ideas to consider in the next few weeks. Make some big purchases of things you can deduct, such as a new business-use car or a business computer (but be careful—the 1984 tax act put some very stringent record-keeping rules into effect). Use your Christmas or year-end bonus for deductible purposes, either spending on deductible equipment or supplies, or even just stashing the money in your IRA account (true, you don't need to put the money in until April 15, 1985, but you've got the money *now*, and the interest it earns from the time you stash it is all tax-free). Also, check out your charitable deductions. Have you got a favorite organization, like the Reason Foundation or the Foundation for Economic Education, that you would like to see prosper? Contribute to them—and let the government pay for part of it.

There's more. Look over your medical bills for the year. If they're already high and you've got a fair chance of exceeding the 5-percent-of-adjusted-gross-income cutoff, go ahead and send everyone in the family to the dentist. Have that operation you've been putting off (or at least *pay* for it).

Does someone owe you money and you *know* you're never going to see a dime of it? Well, take the necessary steps to make sure the debts aren't collectible (consult any popular tax book for the rules governing this area), and then take the losses as nonbusiness bad-debt deductions.

How about nonmoney charitable contributions? You can clean out your attic and throw all that old junk at your church for the rummage sale, or give it to the Salvation Army or Goodwill. Ask them for a receipt, but tell them not to put down their estimates of values. You'll take care of that (your deduction is generally what each object cost you or its fair market value at the time you gave it to charity, whichever is less).

There are plenty of other angles to be exploited, but these give a fair idea of the types available. Also, keep in mind that if you had a low-income year in 1984, all of the above advice is *reversed.* Put all those expenditures off till *next* year if you think your income will be higher then. After all, it won't make much difference if you put something off for a few weeks until early January—*except* for tax purposes, which make *plenty* of difference.

Finally, if you have already made your bundle, remember that the end of the year is the traditional time to take advantage of estate-tax dodges, including the $10,000-per-year gift exemption. This is not an income-tax planning area, but it is something that should be kept in mind to save on the last tax each of us will ever be hit with. (But keep in mind that the nerds on the Potomac who passed and signed the 1984 tax bill froze the estate exemption at $275,000. It was to have increased to $325,000 in 1984 and higher in later years.)

So for all of us who don't like to pay taxes (and who does, other than drooling idiots?) yet didn't do the smart thing by planning for tax savings all year long, it still isn't too late. But you'd better jump on it now, or your beloved rulers in Washington will be thanking you and chuckling at the suckers.

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