POLICY REPORT

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Forces of Gathering Recovery and Economic Growth

By John P. Cullity

The current contraction bears a lot of resemblance to the sharp recessions of 1949, 1954, 1958, and 1975; and so far, few positive signals of an economic upswing have shown up. Some commentators have started to describe the contraction as a depression, but that's a normal reaction for some people in these situations. It's clear, however, that the current slide would have to go a long way to merit the depression label. Normally, contractions in economic activity do not lead to depression, and it's not likely to happen in this case. In the course of a contraction, the market forces making for the downswing are powerfully counteracted by forces that limit the degree to which it can cumulate. This paper discusses a few of these forces, those relating to profits changes, which tend to limit the ability of recessions to cumulate; and it provides some facts on what is currently happening to these forces. In addition, the paper examines the connection between trends in profits and the relatively anemic economic growth in the United States in the 1970s. Lastly, it examines longer run behavior of the proximate determinants of corporate profits and shows their connection with the prolonged inflation of our times.

Forces Leading to Recovery

Numerous forces operate during recessions that brake the cumulative process of contraction.[1] During downswings, sales typically fall less than output drops. Hence, the level of sales soon exceeds the level of production. The liquidation of inventories then proceeds at an increasing rate, but this is a process that cannot be sustained indefinitely. To service the volume of business on hand, manufacturers and distributors will soon slow down, or perhaps halt, the decline in their inventories. From the perspective of the economic system as a whole, once inventory disinvestment declines more rapidly then the decline in sales, production must start rising.

> **"Although many of the recession's readjustments and secondary consequences occasion a good deal of complaint, such changes are a normal part of the recovery process."**

Other developments that grow out of recessions also promote economic recovery. Interest rates tend to decline, and credit becomes more readily available. Furthermore, numerous adjustments in the nation's firms start to blunt the growth of unit labor costs. Specifically, wage rates grow at a slower pace, overtime operations become less frequent, some of the less efficient enterprises belly up, production tends to become concentrated in the most modern plants and on the best equipment, many of the less efficient workers are let go, the ranks of the overhead types of labor are thinned out here and there, and workers become more attentive to their duties. These changes reinforce other improvements that occur in a progressive economy and that are often accelerated during a recession. To be sure, the beneficial blunting of the rises in the costs of production on individual businesses is often offset by declining selling prices. Once the adjustments in inventories have been accomplished, however, commodity prices start to stabilize. Hence, more and more firms find that their profit margins start improving. With the prospects of profits improving and interest rates declining, some of the investment projects which had been shelved are now revived. As these developments become stronger, investment commitments cease to decline, orders and contracts for investment goods turn up, inventory disinvestment continues to ebb, and an expansion of production and employment gets underway. Although many of the recession's readjustments and secondary consequences occasion a good deal of complaint, such changes are a normal part of the recovery process.

The start of this recovery process can be seen in some recent evidence.[2] (See accompanying charts.) Commodity prices have dropped sharply, reflecting the efforts of firms to reduce inventories, the cost of which had become particularly onerous with the high interest rates prevailing at the start of the

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EDITORIAL

Reaganomics After 15 Months

On February 18, 1981, President Reagan submitted his Program for Economic Recovery to the American people. It consisted of four elements:

— a budget plan to slow down federal spending;
— business and personal tax cuts;
— a "far-reaching program of regulatory relief"; and
— a tight monetary policy to reduce inflation.

After 15 months, what have been the results?

Let's look at spending first. In the last full Carter budget — fiscal 1981 — spending was $657 billion. For 1983, the first full Reagan budget, the *lowest* estimate of federal spending is now $767 billion — a $110 billion increase in only two years. Of course, even that figure (from Reagan's Office of Management and Budget) may be low. The Congressional Budget Office currently estimates that 1983 spending will come in at $781 billion if Congress agrees to all the President's budget revisions and at $827 billion if current policies are maintained.

In 1984, OMB projects that spending will rise to $816 billion, while CBO's projections are for $844 or $918 billion. If CBO is right, President Reagan may be submitting the first trillion-dollar budget to Congress as early as next January.

It is true that spending in some areas has been reduced. But as *Policy Report* pointed out in April 1981, the budget-cutters exempted most of the budget from their scrutiny. Indeed, President Reagan's own proposals show that defense spending will soar between now and 1985, Social Security will rise dramatically, Medicare and Medicaid will grow steadily, interest rates will increase, and other entitlements will remain about the same. Only "other nondefense" spending will be reduced. The problem is that "other nondefense" is only about 16% of the budget, so even major cuts in that area just won't have that much impact on the budget as a whole.

The second element of the President's program was a program of personal and business tax cuts. We did get significant reductions in business taxes, though many of them were added by the Democrats in Congress. The most unfortunate aspect of the business tax cut is its structure. Instead of a simple cut in the corporate income tax rate, Congress and the President agreed on a number of different exemptions, credits, and depreciation schedules. The business tax system is probably more complex than before, and a complex tax system means that much economic activity is oriented toward the tax law rather than to real profitability.

As for the personal tax cut, of course, there wasn't one. What happened was that Congress and the President rolled back part of a planned tax increase. Social Security taxes went up in 1981 and again in 1982. (They're scheduled to take another big jump in 1985.) And as inflation moves us into higher tax brackets, most people will continue to pay higher tax rates on the same real income. A single worker making $20,000 in 1977, for example, paid 20.9% of his income in federal taxes. Making reasonable assumptions about the inflation rate, after three years of the Reagan tax cut, he'll pay 22.0%. A married worker with two children making $30,000 in 1977 would see his rate rise from 20.0% to 21.2% in 1984.

We can hardly expect to see the increased economic activity predicted by supply-siders when the "tax cut" was actually a tax increase.

The President's "far-reaching program of regulatory relief" has also turned out to be mostly rhetorical. The Presidential Task Force on Regulatory Relief, headed by Vice-President Bush, reported at the end of 1981 that it had reviewed 2,715 proposed regulations. Of those, 2,412 were approved; 134 were approved with minor changes; and 91 (or 3%) were disapproved. (Another 78 were exempt from review.) Later, OMB announced that one of every 12 requests by federal agencies "to impose paperwork requirements on small businesses" had been denied. Or in other words, 11 of every 12 new paperwork requirements were approved.

While some existing regulations — though not many — have been rescinded, there actually has been a move *away* from deregulation in such areas as airlines, trucking, and entry into the radio business.

Finally, the President promised to reduce inflation, and this would appear to be the one area where he has succeeded. The CPI increased by only about 7% over the past year and actually fell slightly in March. However, as *Policy Report's* "Inflation Monitor" demonstrates, some measures of the money supply are still increasing at 8 to 10% annually. If that continues, we may expect reduced inflation to be a temporary phenomenon. In any case, President Reagan has vacillated in his support of the Fed's at-least-somewhat-tight money policy, so he can hardly take credit for the Fed's sticking to its course despite the President's occasional admonitions to it to loosen up.

There has been a dramatic change in the rhetoric of Washington. Both supporters and critics of the President's program talk as if it had substantially reduced taxes, spending, and regulation. The truth, unfortunately, is that things haven't changed very much. The national debt ceiling will be raised again about the time this report is received; spending is headed for the trillion-dollar mark; deficits are higher than ever; taxes remain high and are getting higher; and Americans continue to suffer from the onslaught of new federal regulations. We can only hope the next 15 months will be better. ■

Recovery and Growth (Cont. from p. 1)

recession. Since the onset of the economic decline, virtually all interest rates have declined and so has the rate of growth of total debt. It is not commonly known, but most interest rates have already fallen farther, in both relative and absolute senses, than during the corresponding phases of most previous postwar recessions. The rate of increase in wages has also come down more than in the average previous recession, bringing wages into closer alignment with underlying productivity trends.

At the same time, rates of increase in consumer prices and the finished-goods component of the wholesale price index have also declined, adding to the downward pressure on interest rates and relieving the impact on real incomes produced by the slower wage gains. These realignments are the good news telling us that the initial stages of a process that takes a little time to unfold has arrived.

There is, however, still some bad news that has to be disclosed. So far, the changes in productivity, unit labor costs, and profit margins have not been good. The quarterly peak in the business cycle was set in the third quarter of 1981, and the fourth quarter figures on these variables reflect the unfavorable developments that typically characterize the early stages of a recession. The first quarter 1982 data on output per hour has just become available, and productivity grew by a slender amount during that period. It is in the later stages of recessions, however, that costs have historically declined relative to prices and helped fuel the recovery. By the spring quarter, a persistence of the movement toward more favorable cost changes discussed above should bring encouraging news about unit costs. In addition, the scheduled personal income tax cut in July should help to maintain demand as those costs soften. Labor costs per unit of output have generally declined or increased only slowly at the start of an economic upswing; interest rates have usually declined as well during these periods. As a result, the prospects for profitable capital investment improve.

A Longer-Run Perspective on Profits Changes

The study of profits received relatively little attention from economists in the 1960s and 1970s (except, of course, for that hardy band of radical economists for whom the level of profits is always too high). The mainstream of the economics profession seemed almost to have forgotten that ours was still a predominantly profit-motivated economy in which what happens — or doesn't happen — depends on perceived profit opportunities. Perhaps the main reason for this neglect was the mistaken belief that profits had risen spectacularly in the 1970s. Those holding that view were perhaps misled by the so-called book profits that businesses reported to their stockholders, which did rise sharply from 1970 to 1978. Those raw profits figures, however, were misleading. In fact, they were becoming virtually meaningless because of the distorting effect inflation was having on profits. Under historical cost accounting — the method widely used then for inventory valuation and universally employed for capital asset valuation — the true costs of producing goods in an ongoing business were far from being fully captured. With an understatement of costs on an accounting basis, reported profits contained an element of inflationary hyperbole that in no sense enlarged firms' ability to pay dividends or add to retained earnings.[3]

The distortive impact of inflation on corporate profits during this period can be plainly seen if one subtracts from these returns the portion associated with inventory inflation and inflation-related depreciation and expresses the remainder in terms of constant purchasing power. After such adjustments, we find the level of corporate profits after taxes in 1972 dollars dropping from about $66 billion in 1966 to a level of roughly $58 billion in 1981. This is a decline in economic profits of about 12% in a 15-year period. Anyone who is speculating about why there was a decline in the growth of capital spending, particu-

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In This Issue

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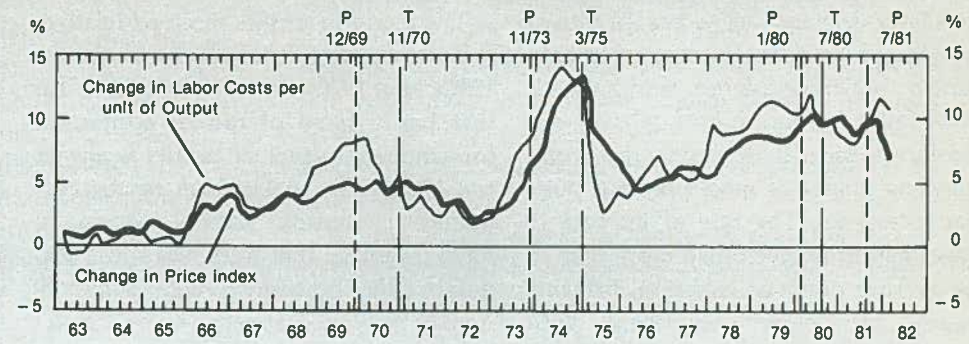
larly spending on structures, during the 1970s would do well to study this dismal performance.

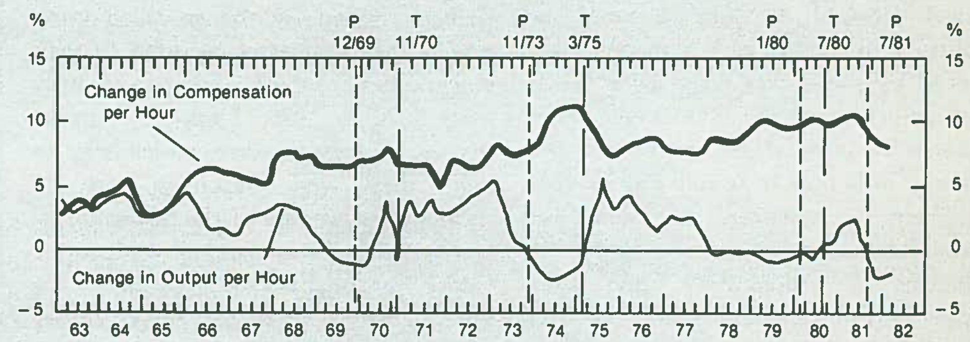
The Economic Recovery Tax Act of 1981 has attempted to provide a partial remedy for this chronic problem by reducing the burden of taxation on capital income, thereby providing substantially greater incentives for capital investment. The most important change is the more generous treatment of the way in which capital can be depreciated for tax purposes — the accelerated cost recovery system (ACRS). Another significant change contained in the law was the introduction of leasing rules that provide businesses with temporarily low taxable income the same investment incentives as other businesses. Still another change increases the investment tax credit for some types of equipment. The combined effect of the ACRS and the investment tax credit will be a decline in effective tax rates on new investment in the 1980s. The leasing provisions permit companies without current taxable income to take advantage of investment incentives by transferring their tax credits and deductions associated with investment to firms with taxable income.[4] A strong case can be made that the sluggish productivity growth in the United States in the 1970s was significantly associated with the high effective tax rates on capital incomes. The tax reductions of 1981 are a good beginning of what needs to be done to improve the climate for business investment. They should be considered as first steps in the development of a long-range fiscal program designed to spur productivity and faster economic growth.[5] To be sure, measures will also have to be adopted over the shorter run to reduce the large deficit currently projected for fiscal 1983.

There is an additional aspect of the dreary record of the recent past we have not yet examined. More specifically, labor costs per unit of production increased at a quickening rate from the mid-1960s through the start of the 1980s because the rise in compensation (wages

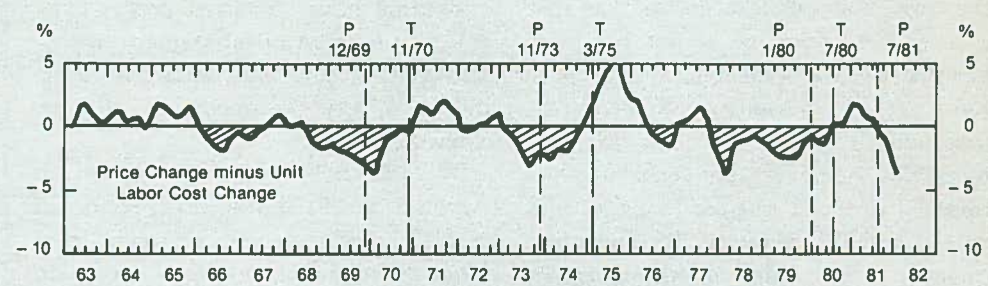
UNIT LABOR COSTS AND PRICES

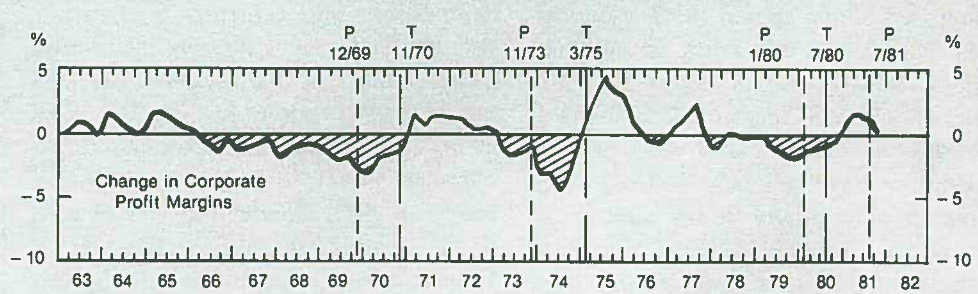


MONEY WAGES AND PRODUCTIVITY



PRICE/COST DIFFERENCE AND PROFIT MARGINS





Source: Rutgers Center for International Business Cycle Research.

plus fringe benefits) exceeded the rise in productivity (output per hour) by a generally widening margin (see charts). Businesses, of course, sought to pass along these increased costs in the form of higher prices; and they were able to do so because of a political environment with a bias toward inflation.[6] Thus, from 1963 to 1981, unit labor costs increased 158% and selling prices 148% for nonfarm businesses.

The economic policy implications where labor costs per unit of production are rising as compared with a regimen in which they are stable or falling are plain. When unit production costs and prices are rising, economic policy must at some point resist this trend in order to avoid runaway inflation. Therefore, a chronic imbalance between compensation increases and productivity improvements and a consequent upward thrust of production costs and prices is not a viable condition for a healthy, growing economy. The evidence of stagflation and inflationary recession in the U.S. and elsewhere during the last 10 to 15 years dramatically confirms the failure of our economic policy to solve this problem.

Summing Up

The implications of recent changes for long-run economic growth in the 1980s are more promising when compared with recent past experience. The tax policy changes, if the trend toward tax reduction continues, represent an important break from the policies of the recent past and focus attention once again on the promotion of employment opportunities and economic growth in the private sector. Moreover, the sharp decline in the inflation rate the past year or two represents the greatest gain in the battle against inflation in memory, and the recent developments in the arena of wage settlements enhance the prospects of stabilizing costs. The fundamental condition of health for an enterprise economy is one in which changes in wages, productivity, costs, and prices are in balance; in fact this is the *sine qua*

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Briefs

☐ The Reagan administration has officially acknowledged that the 1982 and 1983 budget deficits will exceed $100 billion even if all of Reagan's proposed spending cuts are passed by Congress. This revised figure is due primarily to the length and depth of the present recession, which will diminish expected tax revenues, and to still-growing expenditures. Many budget experts outside the administration still feel that the deficit will easily exceed $125 billion.

☐ A study by the General Accounting Office has indicated that six of the federal government's largest nondefense agencies are wasting millions of dollars a year by not using competitive contract procurement procedures. Covering $11 billion in noncompetitive contracts issued by nondefense agencies in 1980, the study concluded that at least 40% of these contracts could have been awarded competitively.

☐ The Pennsylvania State Liquor Board now has a force of 225 agents working to stamp out liquor bootlegging across the Maryland border. (Maryland has privately owned liquor stores with lower prices.) The Board is now spending $14.6 million each year to recover $2-3 million in estimated lost revenues.

☐ Energy Secretary James Edwards has charged that up to 9 million barrels of low-grade "bad oil" may have been pumped into the Strategic Petroleum Reserve, the federal government's stockpile of crude oil. The FBI and a House committee are currently investigating Edwards' claim that waste oil may have been exchanged for high-quality oil during the early years of the reserve. The reserve, which was created in 1975, is expected to cost $33 billion when completed.

☐ The Social Security Administration is becoming increasingly concerned about the number of organizations leaving the Social Security system. Although getting out of Social Security is an option available only to nonprofit or government institutions, there are now more than 500 nonprofit organizations and 300 state and local governments who have officially served notice that they intend to leave the system. This represents a total of about 13 million workers who will be leaving the system in the next two years.

☐ A cross-computer check between the Defense Department and the Veterans Administration has discovered that DOD is still sending benefit checks to 159 dead veterans. The Army alone has paid $570,000 to these dead veterans. Further investigations revealed that the Army and the VA had been double-paying 262 survivors of deceased veterans, at a cost of $3.7 million, over the last seven years.

☐ In a survey of 24 federal departments and agencies, GAO found that Uncle Sam spent $3.3 million on economic modeling and forecasting in 1980 — up $1.8 million from 1978.

☐ According to the Federal Register, six agencies were abolished by Congress, and another 16 by President Reagan, during 1981. Congress created 16 agencies and commissions during that period, however, and the President established 22.

☐ The Washington, D.C., area has maintained its position as the wealthiest metropolitan area in the country, according to the 1980 census. The median family income in the Washington area was $27,515, compared to $19,908 for all families nationwide. Washington was followed by San Jose, California, and the Nassau-Suffolk County area of Long Island. ■

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non of vigorous, sustainable, inflation-free economic growth. The excellent beginning of aligning costs and prices that has begun could obviously be enhanced by policies which would reduce levels of long-term interest rates in the economy. Nonetheless, several important caveats are in order. The public's perception that prospective large deficits in the years ahead will intensify future inflation has to be corrected. Therefore, public policymakers must make it obvious that deficits that threaten to reignite the inflationary spiral will not be tolerated. Should this happen, the impact on interest rates would be significant. We would then have created a setting conducive to the short-term economic recovery and the long-term economic growth all of us are so anxious to achieve. ■

Footnotes

[1]Cf. Arthur F. Burns, *The Business Cycle in a Changing World* (New York: National Bureau of Economic Research, 1969), pp. 37-42.

[2]See Geoffrey H. Moore, *Recession-Recovery Watch*, Rutgers University Center for International Business Cycle Research, Newark, April 19, 1982.

[3]For greater detail, see Burns, *Reflections of an Economic Policymaker* (Washington D.C.: American Enterprise Institute, 1978), pp. 41-52.

[4]For details, see *Economic Report of the President — 1982* (Washington, D.C.: U.S. Government Printing Office, 1982), pp. 78-108.

[5]See John Kendrick, "International Comparisons of Recent Productivity Trends," in William Fellner, ed., *Contemporary Economic Problems, 1981-82* (Washington, D.C.: American Enterprise Institute, 1981), pp. 139-147.

[6]See Burns, "The Anguish of Central Banking," Jacobsson Lecture, Belgrade, September 30, 1979.

Bureaucrats and Education

By Eugenia Froedge Toma

One of the campaign promises of Presidential candidate Ronald Reagan was to dismantle the Department of Education if elected. His administration now is considering a compromise proposal to create a national education foundation that would retain many of the policymaking functions of the present department. President Reagan's failure to fulfill his campaign promise should not be surprising. Education is a large industry in the United States and potential votes are at stake. Educators and administrators will not sit by idly and let their access to federal monies disappear. Even if the most optimistic scenario prevailed and all semblances of a federal education department were removed, the problems of the public school system would not be solved. After all, we have had the Department of Education only since 1979, while Johnny's inability to read, write, or do arithmetic has prevailed for at least the last decade. Still, much of the blame can be placed at federal doorsteps. Federal legislation in the '60s and '70s helped strengthen the role of state education agencies and professional educators in the individual states. The result has been a shift away from parental and taxpayer control of schools at the local level to control by state bureaucrats. The detrimental effect of this shift on the quality of public schools makes education one of the most important social issues of this decade.

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Federal legislation significantly affecting elementary and secondary education is a relatively recent phenomenon. Following the launch of the Soviet satellite, Sputnik, in the 1950s, the federal government began to provide funding to encourage programs in the technical sciences. It wasn't until the passage of the Elementary and Secondary Education Act of 1965 (ESEA), however, that it got actively involved. Title I targeted financial assistance to the so-called educationally disadvantaged. The 1965 law appropriated over $1 billion for local educational agencies to help the children of low-income families.[1]
On the surface, such legislation appears to have little effect on the ability of local districts to make decisions. In reality, however, the ESEA and its subsequent amendments provided the groundwork for the loss of local control. With passage of Title II in 1967, for example, all schools were required to meet *state* requirements in order to receive aid. A more explicit example of a shift of control to the state level was Title V, entitled Strengthening State Departments of Education (SDEs). In this case, 40% of the federal funding had no relationship to income but was apportioned equally among the states to be spent as the state agencies saw fit.

The effect of centralizing the administration of school policymaking has been to shift a greater portion of the net benefits associated with public education to the teachers and administrators at all levels of government and away from students and parents. It is clear that the educational bureaucrats have gained as a result. Total expenditures in public schools have more than quadrupled since 1965. What is most amazing about this spending growth is that it has come about at a time when enrollments in public schools have been declining. So where have the increased funds gone? Over a five-year period, 1968-73, enrollments declined by 1% but total professional staffs grew by 15%; the number of teachers increased by 14% and supervisors, by 44%. Over a subsequent five-year period, 1971-76, similar statistics were recorded. Per-pupil spending rose by 58%. Enrollments declined by 4% but professional

staffs *grew* by 8%.[2] During this entire time, quality was continuing to decline as reflected by decreasing scores on all standardized exams.

It is predictable that with centralized policymaking teachers and bureaucrats gain while consumers of education lose. As the state takes over the responsibility, uniform policies are established that affect all districts and schools. All jurisdictions, rural and urban, rich and poor, big and little, offer the same courses as decided by a state curriculum committee. Teachers for all schools must satisfy state-prescribed certification standards. Books are chosen by the state educational agency. With such actions, the educational output of all schools within the state becomes standardized. While this occurs under the auspices of providing "equal opportunity," the real effect of uniformity is much less laudable. Uniformity of output translates into loss of choice for consumers. If consumers are dissatisfied with their public school's product, they must move out of state in order to find something different.[3] The educators are merely reaping the monopoly gains associated with the more centralized provision of education.

While the general effect of federal legislation over the past decade and a half has been centralization at the state level, differences still do exist among states. The educators' success in implementing monopolistic policies has varied depending on the legal powers of the individual state educational agencies. While all SDEs share certain characteristics, a major difference among states that influence the agencies' policymaking powers is the method of selecting the members of the executive body.[4] The executive body of each state agency consists of a state board of education and a state superintendent. In approximately 60% of the states, the governor appoints the members of the state board. Most of the remainder allow voters to elect this board. State superintendents are appointed by either the governor or the state board or elected in about the same ratio. In many cases, states that provide for election of one body use the appointment method for the other. While several appoint both, only one state elects both the board and superintendent.

Why would the manner of selecting bureaucrats for office have anything to do with the tendency toward centralization of policymaking? From a general perspective, bureaucrats are no different from individuals in private firms in that their actions are determined largely by the constraints they face. The nonprofit nature of government, however, requires bureaucrats to seek rewards through activities that do not involve pecuniary profits.[5] The reward system of

"Federal legislation has encouraged a shift away from parental and taxpayer control of schools at the local level to control by state bureaucrats."

all bureaucracies tends to be structured in such a manner that members desire a more active rather than less active role in policymaking. A bureaucrat benefits in terms of status, prestige, and perhaps even more salary, with the increased responsibility and staffing of his agency. There exists an incentive, therefore, to expand rules and regulations the agency must administer. En route to satisfaction of their own goals, bureaucrats in the state agencies gain more control and power over the provision of education.

Appointed bureaucrats are able to pursue these goals at less cost than those elected to office. To illustrate, consider a hypothetical state with elective posts. In this case, potential members must compete directly for office. The campaign process generates information for the consumers about a candidate's position on education issues. If the candidate favors greater state involvement, this will be revealed. Not only does the election process decrease the costs of information-gathering for voters, they also can act directly on the information by voting.

By contrast, the appointment method obscures the provision of information and increases the cost of acting on it. In this scenario, competition for membership in the agency is indirect, since it depends on the selection of some other official. A gubernatorial candidate may promise to appoint persons to the education agency who will allow localities to make their own decisions, but the promise will be made in the context of an entire package of issues that most closely satisfies voters' desires. Consumers' costs of expressing opposition to educational policies are higher since they must engage in letter-writing, protest marches, or voting against the governor — all of which are indirect methods of opposition. After all, how does the candidate know the opposition vote was because of his stance on education rather than on nuclear power or welfare spending?

As these costs to consumers change under different selection methods, so do those to the bureaucrats of pursuing their own goals. Given these differences in cost, more centralization of decision-making and standardization of output — and, consequently, more monopoly gains for the agency members and educators — can be expected for those states with appointed agencies. The evidence supports this contention. While the trend in all states has been toward uniformity, a great deal of the state-to-state differences can be explained simply by the method of selecting SDE members. The states with appointed state agency members spend significantly more per pupil than do states with elected bureaucrats, other things being equal. That this spending reflects monopoly power and not better quality schools can be seen by examining where the money goes. The salaries of the state superintendents are significantly higher

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✓Washington Update

✓ Sen. Robert Packwood (R-Ore.), chairman of the Senate Commerce Committee, urged that a constitutional amendment be adopted that would guarantee freedom of expression for all forms of communications, including radio, TV, and new electronic technologies. Packwood told a national broadcaster's convention: "Free expression cannot be free when the government assumes for itself, or is granted, the power to regulate in the name of technical necessity. . . . There is no foolproof safe haven for our basic liberties, except the constitution itself."

✓ Agriculture and Interior Department officials have admitted that Reagan's plan to sell off $2 billion of federal land each year is unlikely to succeed. Critics of the plan noted the current depression in the real estate market as well as the lack of sufficiently valuable land remaining under federal title after Watt's "Good Neighbor" policy, which returns land to state and local governments, was implemented. Several officials at the Bureau of Land Management agreed that, in total, there was no more than a couple of billion dollars' worth of land for sale.

✓ The Law Enforcement Assistance Administration has officially gone out of business after having spent $8 billion in the last 13 years in the fight against crime. The agency's basic function was to provide money for law enforcement projects sponsored by state and local governments. Its demise dates back to a decision made by President Carter in 1980. Several of its programs are being picked up by other Justice Department offices.

✓ A Reagan administration proposal that would boost foreign aid by 23% next year has recently run into serious trouble in the Senate Foreign Relations Committee. The proposed increases fall almost entirely in the area of arms credits and loan guarantees, with a proposed increase in the foreign military sales program of $1.6 billion over its current level of $4.1 billion. Sen. Claiborne Pell (D-R.I.), the panel's ranking minority member, noted that "A very heavy burden of proof rests on the administration to justify the increase at a time of budget austerity."

✓ In a 5-to-4 ruling, the Supreme Court has made it more difficult for minorities and women to bring discrimination suits against promotion and seniority systems. Under this decision, which reversed a lower court ruling, those suing under the federal civil rights law must now demonstrate that a promotion or seniority system had discriminatory intent. Although the ruling can be altered by Congress, such an outcome is considered unlikely.

✓ Reversing a decision made last year, the Environmental Protection Agency has ruled that approximately 10,000 hazardous waste disposal facilities will be required to purchase liability insurance. These facilities will now have 90 days to purchase at least $1 million in liability insurance for explosions. Insurance will also be required for leaks of toxic chemicals but these regulations will be implemented over a three-year period.

✓ White House officials are currently considering an oil import fee of $5 a barrel in order to raise an estimated $11 billion in revenue to reduce the 1983 deficit, which otherwise may run as high as $185 billion. Both David Stockman of the Office of Management and Budget and Murray Weidenbaum, chairman of the Council of Economic Advisers, are backing the proposed levy. It is expected that such a tax would raise the price of gas, oil, and other petroleum products by up to 12 cents a gallon, adding a full point to the nation's price inflation rate. Such an increase would cost the government itself several hundred million dollars as an oil user as well as over $2 billion in higher benefits payments triggered by the higher inflation rate.

✓ Attorney General William French Smith has told Congress that the Reagan administration will endorse legislation that would impose stiff fines on employers who hire illegal aliens. The bill currently before both houses of Congress calls for penalties ranging from $1,000 to $2,000, but Smith has been urging harsher fines. Although Smith's proposal has widespread support, many congressmen hold serious doubts about its enforceability.

✓ Administration officials have recently admitted that President Reagan's plans to kill the Departments of Energy and Education are dead for the year. The education proposal has been at least temporarily abandoned due to a lack of support among key Senate Republicans, such as Majority Leader Howard Baker (Tenn.) and Robert Stafford (Vt.), chairman of the education subcommittee. The dismantling of the Energy Department has encountered similar problems, causing one official to remark, "I don't see any way we can get a bill. . . . It's a disaster. . . ."

✓ In a major shift of policy, the EPA is moving to relax restrictions on the disposal of sludge and low-level radioactive wastes in the ocean. An EPA draft noted that the new regulations would "[make] ocean dumping a viable option for waste disposal." Current regulations ban all ocean dumping unless no alternative is available. Low-level radioactive wastes have not been dumped in the oceans since 1970. ■

Bureaucrats and Education (Cont. from p. 7)

in the higher-spending states with appointed bureaucrats.[6] The salaries of teachers are also higher. Additional educator benefits are apparent, with a higher number of administrators per pupil and teachers per pupil in the appointed states.

The evidence shows that these factors cannot be explained by the traditional educators' rationale for more teachers per pupil. Educators always argue that smaller pupil-teacher ratios are in the best interest of the students. Yet dissatisfaction with the public school system is greatest in the states that spend more and employ more teachers as evidenced by the fact that in these states more students opt out of the public system to enroll in private schools.[7] Given this evidence, it is easy to understand why educators advocate removing the control of education from the political sphere. Unfortunately for consumers, putting control in the hands of bureaucrats directly is an even worse solution.

Probably the greatest testimony of all to the extent to which legislation has benefited educators and bureaucrats in recent years is the very passage of a bill to establish the Department of Education. The Carter administration's support for the department was a promise to educators, just as Reagan's promise to abolish it was a promise to consumers. Particularly disturbing about this is the fact that federal bureaucracies tend to be structured along the lines of the more centralized, more monopolistic state agencies. This suggests that the growth in centralization and the subsequent decline in quality can be expected to continue if the education department is not abolished.

Initially, I stated that disbanding the education department would not be sufficient to solve the problems of the public education system. By now, the reasons why this is the case should be clear. Previous federal legislation has resulted in the development of a powerful coalition of education lobbyists both in the public school systems and in the

(Cont. on p. 10)

Regulatory Watch

INTERIOR DEPARTMENT

The Bureau of Land Management has proposed new rules that would streamline several provisions of the existing regulations on the leasing of minerals other than oil and gas. Other sections of the current regulations will be rewritten in order to make them more understandable. Specifically, these proposed rules would: simplify the application/approval procedure; change the method of determining minimum royalties; and increase the bonding requirement from $5,000 to $10,000.

Buffer zones for fish and wildlife protection may be changed if the Office of Surface Mining Reclamation and Enforcement succeeds in amending its rules for such zones. Although a revision of these rules has been drawn up, it is still awaiting public comment and public hearings. If the changes are approved, many of the buffer zones around natural resources and endangered species will be reduced in size.

The National Park Service has proposed rules that would specify what kinds of activities are to be considered "camping" and which of these activities must be confined to specified camping areas. These rules were proffered in response to a dispute in the U.S. Court of Appeals over whether sleeping by demonstrators in connection with the conduct of their First-Amendment activities constitutes "camping." Under the NPS proposal, demonstrators would be restricted to specified camping sites.

Significant portions of the Federal Land Policy and Management Act of 1976 would be amended and clarified by rules drawn up by BLM. The proposed rules would eliminate "needless, burdensome, and counterproductive provisions" contained in the existing right-of-way regulations with regard to land grants.

NPS has amended its regulations for the Urban Park and Recreation Recovery Program in order to permit supplemental grants to the existing grants upon approval by the program director. Such an amendment is necessary to activate the $7.7 million that had been allocated to the UPARR program for fiscal 1982. These grants would be aimed at improving local recreation programs.

The Fish and Wildlife Service has proposed rules to implement the Fish and Wildlife Conservation Act of 1980 that lay down standards for federal wildlife conservation grants to state and local governments. Such regulations would clarify the funding requirements in the act and coordinate them with already-existing requirements. Most of the grants under the act are awarded for the preservation of nongame species of fish and wildlife.

A detailed review of the status of endangered animal and plant species is being conducted by the Fish and Wildlife Service in response to an agreement made at the last meeting of the Convention on International Trade in Endangered Species of Wild Fauna and Flora. Although preliminary results have recently been announced, the Service is still seeking additional information and recommendations from experts and the public. Once the study is completed, new international regulations concerning the import and export of endangered species will be drawn up and submitted to the next International Convention. ■

Bureaucrats and Education (Cont. from p. 9)

government regulatory agencies. Actions taken by the federal government to strengthen state agencies have resulted in huge losses for consumers of public education. Diminishing the monopoly power of the existing system will require not only abolishing the federal department, but changing other laws as well. Entirely removing the federal government as a participant in education would be a first step toward granting control to the consumers. Eliminating federal subsidization of the state agencies' powers would put taxpayers in a better position to reverse some of the recent trends toward state assumption of previously local control.

Finally, what does this imply about the latest education policy proposal of the Reagan administration — the private school tuition tax credit? It actually says two things. On the one hand, any actions that can be taken to reduce the artificial advantage of public schools, and thus to encourage the development of substitutes, can be viewed as a positive step. With tax credits, the costs of opting out of the public system are reduced. Consequently, more people will be able to choose to attend private schools. This in itself will serve to decrease the ability of bureaucrats to reap benefits for themselves, for the resulting competition from private schools will require that they produce a higher-quality product in order to retain consumers of public education.

A word of caution is needed, however. This caution stems from the fact that the federal government classifies tax credits as government expenditures. With "expenditures" from the federal level for private schools, there is an increased probability of private schools being subjected to the same centralizing rules as the public schools. Surely the one thing worse than the present monopoly in public schooling, from the consumers' perspective, would be the monopoly of all schools — public and private. This suggests that any tax credit legislation should be drafted with this possibility in mind. ■

Footnotes

[1]For further discussion of federal spending programs on education, see Eugenia Froedge Toma, "Education," in Eugene J. McAllister, ed., *Agenda for Progress: Examining Federal Spending* (Washington, D.C.: The Heritage Foundation, 1981), pp. 197-215.

[2]Milton and Rose Friedman, *Free to Choose* (New York: Harcourt Brace Jovanovich, Inc., 1980), p. 156.

[3]Another option is to "double-pay" and choose private schools.

[4]A similar characteristic of all SDEs is that their lower tier consists of numerous civil servants and appointed professionals — a characteristic that is typical of bureaucracies in general.

[5]See William A. Niskanen, Jr., "Bureaucrats and Politicians," *Journal of Law and Economics* 18 (December 1975): 617-43, for an in-depth discussion of bureaucratic behavior.

[6]Toma, "Bureaucratic Structures and Educational Spending," *Southern Economic Journal* 47 (January 1981): 640-54.

[7]For a more rigorous analysis of the process by which the educators gain from the standardizing activities of state educational agencies, see Toma, "Institutional Structures, Regulation, and Producer Gains in the Education Industry," 1982 CSUN working paper.

GOVERNMENT SPENDING MONITOR

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

	EXPENDITURES (annual rates in billions of $)			
	1982 1st Quarter	**1981 4th Quarter**	**1981 3rd Quarter**	**Average for Last Year**
Federal Government	664.4	781.6	661.1	694.2
Defense	176.3	176.5	165.0	169.4
Labor	32.0	23.4	26.5	27.5
Education	14.2	16.4	13.7	14.8
Health and Human Services	193.7	299.6	245.5	242.0
HUD	13.0	16.0	11.3	14.3
Energy	8.3	7.6	12.8	10.8
Transportation	18.8	20.2	23.4	20.2
Federal Aid to State and Local Gov'ts.	82.9	82.9	87.0	85.4
Federal Interest Paid	101.1	125.4	97.7	106.6
Federal Transfer Payments	302.4	297.2	292.1	291.7
Federal Surplus or Deficit	–94.8	–192.8	–34.3	–76.4
Reported Federal Debt (at close of quarter)	1,066.4	1,028.7	1,003.9	1,018.4
Total Government Employment, All Levels (millions)	16.2	16.1	15.3	15.9

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

PR Reviews

The Money Lenders — Bankers in a Dangerous World, by Anthony Sampson. Viking Press, New York, 1982. 336 pp. $16.95.

After having written a series of "exposés" about IT&T, the "Seven Sisters" oil companies, and the arms trade, British journalist Anthony Sampson has turned his attention to the world of international banking and lending. With the aid of a colorful writing style, Sampson examines the men, the politics, and the economic forces behind the loan-making process. He gives special attention to borrowing by Third-World nations, which now accounts for a significant portion of international lending. Other topics briefly, but adequately, examined are the history of banking, the roles of the International Monetary Fund and the World Bank, the rise of the Euromarket, and the relationship between banks and the federal government.

Sampson's main thesis is that something has gone fundamentally wrong in the international banking arena: American banks have systematically overextended their loans to foreign nations (especially in the Third World) and now find that such overexposure is threatening their financial viability. The cases of Ghana, Indonesia, and more recently, Poland and Rumania, lend strength to Sampson's thesis. It is this focus on overextension — one of the most important, yet most ignored, economic problems in the world today — that is the book's greatest asset. Despite this virtue, *The Money Lenders* is ultimately unsatisfactory since Sampson does not even attempt to explain the causes of this phenomenon. If one reads this book armed with an understanding of how the Federal Reserve's inflationary credit creation leads to an artificial expansion of loans, however (see F. A. Hayek's *Unemployment and Monetary Policy*), it is a gold mine of information for applying business-cycle theory to international finance.

Supply-Side Economics: A Critical Analysis, edited by Richard H. Fink. University Publications of America, Frederick, Md., 1982. 450 pp. $27.50.

Of all the collections and books that have come out on supply-side economics in the last year, this one offers the broadest array of perspectives. The essays in this volume may be divided roughly into three camps: pro-supply-side, anti-supply-side, and the market-process view, which takes a balanced position. Some of the best supply-siders, such as Paul Craig Roberts, Arthur Laffer, Bruce Bartlett, and Norman Ture, are represented. On the whole, they offer a succinct explanation of what supply-side economics is and why it is superior to Keynesian economics. In the anti-supply-side camp are such writers as Lester Thurow, Walter Heller, and Robert Heilbroner. The economic reasoning in these pieces represents attacks from the "left" and are an important aspect of the debate.

The most original aspect of this volume is the Austrian or "market process" viewpoint. Editor Richard Fink, who serves as managing editor of *Policy Report*, puts all the pieces in perspective in his introduction. Fink also has contributed an article on economic growth, in which he argues that while supply-side economics has performed the valuable function of refocusing attention on problems of growth, its aggregative approach causes it to miss many of the important problems surrounding the *structure* of capital.

The book also includes several relevant studies of economic history and the history of economic thought. ■

"To be governed . . ."

Is that a safety net in the middle of the court?

Leslie Jackson isn't worried about finding a job. She spent a sunny weekday recently practicing her forehand at [wealthy New York suburb] Bronxville's exclusive Field Club. Clad in Ralph Lauren T-shirt and matching sweat pants, she observed, "There's so much money in Bronxville, the recession makes no difference at all."

Miss Jackson, who is 25, plans to start working soon at a Florida resort. Since January, she has been collecting unemployment compensation after being fired from a restaurant job (for arguing with a customer). Her father, a lawyer, and her mother, a professional tennis referee, have been providing a comfortable home, a club membership and a silver Mazda sports car with the license plate "LSJ-2."

—*Wall Street Journal*, April 20, 1982

So are we

Boston's city clerk says he deserves a disability pension of $28,000 a year because he's plagued with nightmares about City Council meetings going out of control.

—*Washington Post*, April 7, 1982

Demand-side economic growth

Ann Digges, Student Engineers' Council member [at Virginia Polytechnic Institute]: "We are sort of ambivalent about the talk of an arms freeze. Of course, we want to hear about it, but on the other hand the money and the best job offers come from nuclear companies, defense companies."

—*Washington Post*, April 5, 1982

Balancing the budget

After forcing Carter appointees to the Synthetic Fuels Corp. to halve their salaries last year, the Reagan Administration is now considering a proposal to increase sharply the $69,630 annual pay of two of the quasi-public corporation's top executives. Synfuels Chairman Edward E. Noble wants to raise the salary of Victor A. Schroeder, the corporation's president, to $135,000, and is also seeking to increase the salary of Leonard C. Axelrod, vice-president for technology, to $108,000. White House Counselor Edwin Meese III is cool to the idea, but Noble is arguing that the low pay ceiling at the corporation is hampering the search for a chief financial officer and a key vice-president.

—*Business Week*, April 26, 1982

Only 5,648 new regulations to obey!

Speaking of regulatory reform, the Office of Management and Budget has just issued another update on what it has accomplished so far. It says the Reagan administration issued 21 percent fewer final regulations (5,648) its first year than the Carter administration issued (7,192) in its last year in office. OMB attributed this partly to the "discipline" it said it had imposed on the bureaucracy by giving every regulation a cost-benefit review, except for extremely routine ones. Last year, OMB questioned 233 of the 2,803 rules sent to it for review. Minor changes were required in 138 and the remaining 95 were sent back to the agency for reconsideration or were withdrawn.

—*Washington Post*, April 26, 1982

Shuttle diplomacy?

Just when White House aides were starting to think they could work harmoniously with Alexander Haig, the Secretary of State blew up over the type of plane he was assigned for his London-Buenos Aires peacemaking shuttle. The incident raised fresh doubts in minds of presidential advisers about Haig's ability to fit into the administration team.

—*U.S. News & World Report*, April 26, 1982

No competition

In the free markets of China's Chichuan Province, the thought of Marx, Lenin, and Chairman Mao is now competing with the Protestant ethic and the spirit of capitalism. In one stall a peddler of rat poison puts out four furry corpses to boost sales. "Advertising might help," he muses, studying the booths of other poison dealers nearby. In a crowded alley more than 100 private tailors snip, stitch and turn out suits for as little as $2, cashing in on volume. "We never go short of customers," grins one iconoclast: his $70 monthly earnings have made him twice as wealthy as the average worker who goes by the Marxist book.

—*Newsweek*, April 12, 1982

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