POLICY REPORT

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The Social Security Drag on Capital Formation

by Stanley Kaish

Reindustrialization is one of today's buzz words. In this election year it appears that everyone has awakened to the importance of productivity and begun to pay lip service to our need to improve plant and equipment. If we were all Keynesians in the 1960s, we're all supply-siders in 1980.

There can be little doubt that recognition of America's productivity difficulties is long overdue. Red ink splashing across the income statements of our auto companies in 1980 caught the public's attention because it was headline news. Less spectacular but more ominous is the message carried by President Carter's economic report this year, showing that average output per man-hour—which had grown 2.5% per year from 1948 to 1965—grew by 1.6% per year from 1965 to 1973, by 0.8% from 1973 to 1978 and by minus 2.0% in 1979. All reports are that the record for 1980 is worse. The result has been a decline in real standards of living as the goverment's stimulation of aggregate demand has caused higher prices rather than greater supplies of goods and services.

The reindustrialization recommendations coming from our presidential candidates all recognize a need for improved capital formation. They all call for changes in the way that depreciation is calculated, and many advocate tax relief for businesses and encouragement of research and development spending and new investment. Training programs to improve the skills of workers are popular. Some even make the mental jump that Böhm-Bawerk made 100 years ago from needed capital formation to higher rates of saving in the economy in order to permit this increased investment to take place. Proposals designed to increase the rate of saving include lower taxes on dividend and interest income, less progressivity in the tax schedule with bracket indexing against inflation, and even such radical notions as switching away from income as the base for taxation to a consumption or value-added tax. Inseparable as ham and eggs or meat and potatoes, investment requires saving within the economic system.

> **"It is increasingly clear that the social security system is a major obstacle to capital formation in our country."**

Ironically, while the focus of actual or would-be government policy makers has been on ways to induce the private sector to reallocate its spending away from consumption and toward investment, there has been remarkably little heard about the impact the growth of government transfer payment programs has had on investment. Perhaps this is because tampering with the social security system is a highly sensitive political issue: One out of every seven Americans receives a social security check each month, and any perceived threat to this flow arouses quick response. Nevertheless, it is increasingly clear that the social security system is a major obstacle to capital formation in our country. One estimate maintains that our total plant and equipment would be 50% higher without it.[1]

Before pursuing the argument it is helpful to examine some figures. In price-adjusted, real terms, government transfer programs have grown from 8% of our Gross National Product in 1950 to 16% today. While the overall economy grew at a compounded real rate of 3.4% annually from 1950 to 1979, transfer payments increased at a 9.5% rate; between 1970 and 1979 growth of transfers exploded at a 13.5% compounded annual rate. In 1979 federal government transfer programs have grown from 8.0% of our Gross National Product in 1950 to 16.0% today. While the overall economy grew at a compounded real rate of 3.4% annually from 1950 to 1979, transfer payments increased at a 9.5% rate; between 1970 and 1979 growth of transfers exploded at a 13.5% compounded annual rate. In 1979 federal government transfer payments were $252 billion, a figure that takes on more significance when measured against a total gross investment by business of less than $150 billion that year. This growth of transfer payments reflects social priorities that give a special claim on the resources of the country to various groups. Although they differ in particulars, the groups generally share the characteristic of needing to spend the money they get immediately.

Social security has grown from a $1 billion program in 1950 to a $132 billion program in 1979 by offering more benefits to the people it serves and by serv-

(Cont. on p. 3)

Stanley Kaish is chairman of the Department of Economics at Rutgers and a former mayor of Springfield, N.J.

EDITORIAL

The National Parks—Urban Blight?

The past summer saw the continued acceleration of the destruction of America's great national parks as the problems they suffer from became so severe they threatened the environmental integrity of the park system. This tragic situation, the needless destruction of nature's beauty, is particularly disgraceful because the very idea of national parks—preservation of the wilderness—was invented in the United States, and this country boasts more parks than any other country in the world. The parks stretch from Maine to Alaska and include vast acres of wilderness along with urban parks in New York and San Francisco. They encompass the White House, the Wolf Trap Farm Theatre in Virginia, Valley Forge, and a long list of other national and historic sites including Yellowstone, Yosemite, and the Grand Canyon.

One of the fundamental goals of the National Park Service is to preserve certain areas of the country from commercial and industrial development and to set aside wilderness areas for future generations. Although many have questioned the goals themselves, others have merely questioned the success of the government in meeting these goals after the expenditure of billions of taxpayers' dollars. Even the government itself has serious doubts about its own efficiency: This past spring the National Park Service quietly issued a "State of the Parks" report that outlined serious threats to all 326 units in the park system. Over 70 different kinds of threats were analyzed and grouped under seven broad categories that included air pollution, water pollution, the negative impact of the volume of visitors, and the state of park operations. The report's summary reads, "Simply stated, the current levels of science and resource management are completely inadequate to cope with the broad spectrum of threats and problems which have been identified and discussed in this report."

The park situation has become so bad that one wonders whether city dwellers are escaping to the parks in the summer or whether park dwellers are escaping to the city in the winter. Problems confronted in national parks this past summer sound more like problems suffered in the lowest income areas of major cities: traffic jams that rival Los Angeles's freeway rush hour, polluted water, violent crime, theft, crowded jails, noise pollution, and rangers carrying guns—not to protect people from bears, but to protect bears from people. Accompanying these urban problems are environmental problems such as the rampant destruction of vegetation, invasion of the homes of wildlife, litter scattered everywhere, and the scarcity of infant trees, including the redwood, to replenish the present stock.

For years, economists have predicted the type and scope of problems associated with resources managed in this way, and history is replete with examples of the overuse and degradation of common-property resources. The near extinction of the American bison, the excessive slaughter of the sperm whale, the erosion of the European commons, the desertization of the famous cedars of Lebanon, and the creation of the dust bowl in the western United States (through overgrazing of livestock) are all examples of the results of allocating resources according to the principles employed by the U.S. Park Service.

Perhaps the most puzzling aspect associated with the administration of the parks is the lack of awareness on the part of officials that the real problem lies in the incentive structure facing park users. Since the land is public, every visitor has the incentive to use as much of this resource as he can. Every resource that the visitor leaves he leaves for someone else; every resource that he uses in his weekend or week-long stay he benefits from directly. There is simply no incentive for the user to conserve the available resources, and therefore it should not be surprising to see that the same people who spend hours every week watering and fertilizing their lawns end up trampling the vegetation in the national parks. The case is economically identical to that of the cattle ranchers who allowed the overgrazing of public lands while maintaining lush pastures on their own property. What is surprising is the inability of the National Park Service to appreciate this simple truth.

The only effective way to deal with common-property resource problems is to redefine property rights so as to provide an incentive structure that encourages people to take responsibility for their actions. Privately owned land automatically provides this incentive.

It is not hard to guess how the National Park Service will deal with the problem of the destruction of the parks. We are already beginning to hear the familiar request for more tax money. When the additional funds do not solve the problems, the next step will be to institute strict regulations on park use and finally, when all else fails, to search for a nongovernment scapegoat. Unfortunately, this problem will never be solved by unlimited subsidies or fictitious villains: It will remain until the resources are allocated in accordance with private property incentives.

While we are sympathetic to the cries of the administrators of the National Park Service, we are reluctant to waste tax money on inappropriate solutions. The fundamental question is: Can a government bureaucracy continue to provide national parks at all? ■

ing more people. It has evolved from an Old Age Insurance program passed in 1935 to Old Age and Survivors Insurance in 1939 to Old Age, Survivors, and Disability Insurance in 1954 to Old Age, Survivors, Disability, and Health Insurance in 1965 to price-adjusted Old Age, Survivors, Disability, and Health Insurance in 1972.

As it has grown, so too has a coterie of worriers who shake their heads over the tenuous solvency of the system and rail at its obvious inequities in distributing the blessings of its benefits and the burdens of its support. Certainly there is ample cause for concern about the solvency issue now that the benefits have become tied to the consumer price index. In July of this year that linkage produced a 14.3% increase in benefits, far in excess of anything forecast by social security planners. Meanwhile, when contributions became based on wages, the advent of lagging productivity, presidential wage-price guidelines, and rising unemployment rates worked to hold revenue down and create a gap between annual benefits and contributions that threatens to make short shrift of the trust fund. Many persons experienced a feeling of déjà vu when they read the 20 June 1980 article in the *New York Times* beginning, "The Carter administration said today that the money to pay old age social security benefits would run out late in 1981 unless Congress took action." How reminiscent this was of the 27 February 1975 *Wall Street Journal* headline, "Social Security System is on way to going broke, analysts warn; Payments outstrip income." The social security formulas underwent drastic revision in 1977 to correct for errors made in the 1972 law and to provide sound financing well into the next century. Nevertheless, three years later the system is once again listing heavily.

While the question of its solvency produces worry, concern over the issue of social security's equity seems to generate alternating moods of rage and dismay. Many analysts find the regressivity of the payroll tax a most distressing feature. To others, the unequal treatment given women and married couples raises their bile. Some are upset because there is no test of financial need to determine who is eligible for financial benefits. The absence of government workers from social security upsets some critics because this excuses the workers from participation in the redistribution of income inherent in the social security benefits schedule. The fact that the earnings test to determine eligibility to receive benefits between ages 65 and 72 involves only wages and not dividends or interest is seen as representing a major inequity. And the system's compulsory nature makes many young people worry that they are putting more into the system than they will take out. On the other hand, most of today's retired people are taking out far more than they put in.

We could go on at some length to elaborate on these discrepancies between the reality and the ideal. There are those like former HEW secretary Wilbur Cohen who acknowledge the inequities but defend them as the only way to win broad-based support for the program.[2] Be that as it may, it is certain that the system did not win too many friends from the recent revelation that many prison inmates (including David Berkowitz, the notorious "Son of Sam" killer) receive monthly social security disability benefits for mental disturbance.

Although the solvency and equity issues anger many critics of social security, these matters should pale in comparison to the impact the program has on our national saving rate, our capital stock, our productivity, and hence our total well-being. One needn't be a member of a particular group to be concerned about a program that economic analysis suggests cuts our Gross National Product by a conservatively estimated $120 billion per year. Yet for all the talk and "task-forcing"

(Cont. on p. 4)

In This Issue

The Social Security Drag on Capital Formation 1

The National Parks—Urban Blight? (Editorial) 2

The Synthetic Fuels Program 6

Features:

Briefs 5

Trade Regulations—FTC Watch 7

Washington Update 8

Government Spending Monitor 10

"To be governed..." 12

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Social Security (Cont. from p. 3)

that goes on in Washington regarding investment incentives associated with reindustrialization, there is little indication of awareness or concern over the impact of social security on our nation's output.

When the social security system began operating in 1935, underconsumption was viewed as a major economic problem. The main purpose of the program was to provide income insurance, and the fact that it also discouraged savings could only be seen as an added benefit. Circumstances today are vastly different. Capital scarcity is the problem, not capital surplus. Nevertheless, the machinery put in motion during the depression remains in motion today, working to hold down saving and encourage personal consumption expenditure. Let us examine how social security produces this result.

Most contemporary economic models incorporate some form of the life-cycle hypothesis of consumer behavior. In essence, this theory suggests that people apportion their income between consumption and savings in a manner designed to even out the level of consumption they can enjoy over their lives. This requires that they accumulate financial assets during the productive working years in order to provide for retirement. In calculating the assets they intend to use during the retirement years, people include savings accounts, stocks, pensions, property, and, of course, social security. Social security is the largest single asset most people have. According to the Social Security Administration, the system is designed to replace 62% of an average wage-earning couple's income. Indexing maintains the purchasing power of these benefits, and their tax-free nature raises their value to the beneficiary even further. All in all, the assurance of an annuity lasting from retirement to the death of the wage earner, and beyond that to the death of the wage earner's spouse, represents a substantial asset. Estimates place the annuity value at $2.029 trillion in 1971 and $3.5 trillion in 1978.[3] Today, with the rapid inflation we have experienced, consumers can count on social security asset values in the neighborhood of $5 trillion and plan their savings accordingly. Without these assets consumers would certainly save more and consume less.

> **"While the question of its solvency produces worry, concern over the issue of social security's equity seems to generate alternating moods of rage and dismay."**

There are many forms of private pension systems that guarantee income security in old age. Why then single out federal social security for this harsh indictment of savings loss? The reason is that the financing of social security is unlike any other private pension plans a worker may have. Although social security is called insurance, that is a misnomer; it is actually a pay-as-you-go transfer program. Contributions made by today's workers do not go into a trust fund that is set aside to earn interest and will be used to provide retirement benefits for the contributor tomorrow. On the contrary: Today's contributions go directly to today's retired people, who (according to the life-cycle hypothesis of consumer behavior) spend the money almost immediately. There is no massive trust fund. Social security represents no savings.

As far as individual behavior is concerned it makes relatively little difference if there is a fund or not. In fact, most citizens are probably unaware of the peculiar nature of social security funding. Milton Friedman has made much of the intentional use of what he terms "Orwellian doublethink" by the Social Security Administration (SSA) in its dealings with the public.[4] He charges that the SSA intentionally disguises the fact that a worker who contributes today actually has no assets per se. He has only the government's assurance that a future generation of workers will similarly contribute when his retirement time comes. Because the individual neither knows nor cares how his social security is financed, he behaves as if the savings are in place.

To the economy as a whole, however, the difference between a funded pension system and a pay-as-you-go transfer system is substantial. The former provides loanable funds for investment and capital formation, and the latter does not. Personal savings, insurance, or pension money is deposited in the banking system, where it serves as reserves to be loaned out to business for capital formation. With social security, because there is no loanable fund equivalent, there are no real resources set aside from consumption use. This important part of the saving process is missing. Instead there is the heightened level of consumer demand that results from a transfer from producers to consumers and the consequent allocation of resources to satisfy it.

Martin Feldstein has studied extensively the impact the social security system has had on our Gross National Product.[5] His conservative estimate of a loss of $120 billion per year follows from his finding that people forgo one dollar of saving for every two dollars of social security annuity they hold. Because there was $3.5 trillion in assets factored into people's consumption decisions in the late 1970s, this would indicate a savings loss of $1.75 trillion. Allowing himself ample margin for error, Feldstein assumes a loss of $1 trillion of savings, with its equivalent loss of $1 trillion in capital stock. Since capital in the United States returns an average of 12%, the loss is $120 billion of annual income.

Assuming proponents of reindustrialization are serious about their desire to increase capital formation in the American economy, what can they do about this social security drain on capital?

To begin to understand what the prospects for relief are, we must first see why the system is funded by pay-as-you-go methods and not through a trust fund. It would certainly be more conventional and a good deal cheaper to have a trust fund because it would earn interest that would reduce the contributions needed to fund a particular level of benefits.

It all began back in 1939 when the first generation of retirees received benefits, although they had not paid into the system. Instead, the now familiar method of using current receipts to pay for their benefits was employed. Because that first generation of workers got a free ride 40 years ago, social security today continues its pattern of pay-as-you-go funding. To change today we must drop that free ride, either by skipping the benefits paid to one generation or else by having another generation pay in twice, once for the group they are supporting in the normal way and once for themselves. Neither is an appetizing prospect for politicians.

As might well be expected, the world does not lack proposals to revise the social security system. Most are aimed at the problems of equity and solvency and involve, in one form or another, a switch from the payroll tax to general revenues as the source of social security funding. This change to financing social security through the income tax would reduce the regressivity of the program and eliminate once and for all the problem of solvency. It would, however, do nothing about the saving problem. Social security would continue to be a massive transfer program providing the benefits of saving to the individual but not to the capital-building investment community.

To deal with the saving issue we must raise amounts of money that go substantially beyond the current year's distribution of benefits. These can be accumulated and distributed in later years in place of concurrent payroll taxes raised at that time. Friedman has proposed a halt to all further growth of pay-as-you-go social security. He wants eventually to replace social security with the negative income tax, but in the meantime he would rely on general revenues to carry the burden. He points out that such a change would have the dual benefit of eliminating the illusion that one's payments were somehow set aside for one's own retirement and would also put social security into competition with other claims on the general revenues when proposals come up to increase benefits. Feldstein addresses the saving problem directly by proposing that payroll taxes be increased beyond the level of benefits so a reserve can begin to accumulate. He would extend the re-

Briefs

□ A recent study by *U.S. News & World Report* has estimated that there are now 3 million nonmilitary federal workers in the United States. Employees of Uncle Sam now earn, on average, 28% more than workers in the private sector. They also recieve 20 days of annual leave after three years of service and 26 days after 15 years, as well as nine paid holidays. The insurance plans and retirement benefits for federal workers are usually superior to those in the private sector.

□ The Federal Trade Commission has released a report that claims that the cost of prohibiting imports exceeds the benefits. Although cost-benefit analysis is incapable of discovering the hidden costs of government regulation, which are ultimately unmeasurable, the study does present some interesting figures. The FTC report estimates that the higher prices on textiles, sugar, color television sets, citizens band radios, and nonrubber shoes due to import restrictions cost the American consumer $2 billion a year. Restrictions in the textile industry alone will cost more than $5 billion over the next four years.

□ Responses to President Carter's plan to help the auto industry have been frighteningly honest about the role of government in American business. General Motors Chairman Thomas Murphy said, "I think an important and historic first step has been made. . . . The idea of an ongoing dialogue, a close working relationship among industry, government, and labor is a very, very important thing for this country." Ford Chairman Philip Caldwell called the theme of cooperation "probably the greatest lesson we can learn from the Japanese." Stuart Eizenstat, a key adviser to the Carter administration, said that the auto plan might serve as a "model for industrial policymaking for the 1980s."

□ The Department of Energy is encountering obstacles from other government bureaucracies in its attempt to promote the use of coal. At the same time that the DOE is trying to keep down rail rates for hauling coal (in order to encourage plant conversions) the Transportation Department is attempting to keep coal rail rates high in order to help the sagging railroad industry. Another example of intragovernmental confusion is afforded by the Environmental Protection Agency, which is hindering the use of coal by its push for strict controls on air pollution.

□ The Department of Justice has issued a 165-page report saying that the 1979 gasoline shortage was not the result of an oil company conspiracy. The study blamed the shortage on the loss of Iranian crude production, the decreasing quality of imports, an increased demand for lead-free gasoline, and the weather. Conspicuously absent from this list of causes are such government regulations as price controls, import quotas, and the complex gasoline allocation system. ■

tirement age when full benefits can be collected to 70 and reduce the benefits paid to those retiring earlier. Michael Boskin would separate the insurance from the transfer aspects of social security.[6] He would assign the legitimate transfer of income from rich to poor to the general taxing authority and use an actuarially funded program to provide social insurance. Transition, as in Feldstein's case, involves raising taxes beyond immediate benefits on the insurance part.

Beyond these, there have been proposals for bonding the transition out of the pay-as-you-go program. Universal pension proposals have been made that would build a fund through an additional 1% tax on all payrolls. One recent plan that I have discussed elsewhere is a program of compulsory saving modeled on Keynes's wartime financing program proposed in 1940.[7]

In considering the social security dilemma, Professor Norman Keyfitz wrote a melancholy paragraph that warrants repetition:

> It may be impossible to change from pay-as-you-go. Perhaps the original giveaway has to be paid for by retention forever of a system that forgoes interest, in which saving in the economy is inadequate, in which it becomes less and less possible to play the chain letter game, so taxes keep rising. Pay-as-you-go could be a trap in which the payments by each generation commit society to continue in the same way with the generation that follows, and so on *ad infinitum*.[8]

Indeed it may be. But in light of the importance of the matter, let's hope it isn't. ■

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[1] Martin Feldstein, "Social Security Hobbles Our Capital Formation," *Harvard Business Review*, July 1979.

[2] Wilbur Cohen, Jr. and Milton Friedman, *Social Security: Universal or Elective* (Washington, D.C.: American Enterprise Institute, 1972).

[3] Martin Feldstein, "Social Security, Induced Retirement, and Aggregate Capital Accumulation," *Journal of Political Economy*, September-October 1974.

[4] Cohen and Friedman, *Social Security*.

[5] In addition to the two references cited, see his articles in *Public Interest*, Spring 1977, and *Review of Economics and Statistics*, August 1979.

[6] Michael J. Boskin, *The Crisis in Social Security* (San Francisco: Institute for Contemporary Studies, 1977).

[7] Stanley Kaish, *New York Times*, Business and Finance Section, 6 April 1980.

[8] Nathan Keyfitz, "Why Social Security Is in Trouble," *The Public Interest*, Winter 1980.

The Synthetic Fuels Program:

Energy Salvation or the New Fascism?

by Richard M. Ebeling

In a 10 October 1975 letter to the Speaker of the House of Representatives, President Gerald Ford argued that "America cannot permit the excessive delays associated with commercialization of unconventional energy technologies" to delay the development of synthetic fuel alternatives. "New production is essential," he said. "Our national security and economic well-being depend on our ability to act decisively on energy."

Five years later on 30 June 1980, President Jimmy Carter signed the Energy Security Act, which established the United States Synthetic Fuels Corporation. "This is a proud day for America," declared the President. "The bill establishes a corporation to encourage production of two million barrels a day of synthetic fuels by 1992."

Having allocated $20 billion to give the program an initial kickoff ($12 billion to the Synthetic Fuels Corporation over the next two years; the remaining $8 billion goes to various other "alternative" energy programs), Congress has held out the promise of billions more to follow. How many more billions? The bill authorized the Corporation to request an additional $68 billion in future years. In President Carter's words, the $20 billion will serve purely as a springboard for capital expenditures on energy alternatives that "will dwarf the combined programs that led us to the moon and built our Interstate Highway System." (The Federal expenditures to land a man on the moon came to $35 billion.)

Richard M. Ebeling, a former instructor of economics at Rutgers, is presently at the University of Ireland at Cork.

Synthetic fuels (i.e., liquid oil and gas derived from coal, shale, tar sands, or agricultural and forest products) potentially represent a huge source of energy for the United States. It is estimated that recoverable coal deposits in America are equal to 1 trillion barrels of oil, and shale deposits represent 600 million to 1 trillion barrels of oil.

Nor is the idea of extracting oil from these raw materials farfetched. In fact, before the first oil wells were sunk in Pennsylvania in 1859, 53 U.S. companies were deriving oil from shale. And as part of his drive for "national self-sufficiency," Hitler had Nazi Germany's chemical companies producing 100,000 barrels of synthetic fuel per day during World War II.

The Synthetic Fuels Corporation has been given the power to extend loans, loan guarantees, and purchase agreements to companies that sign up to participate in what President Carter has called "the cornerstone of U.S. energy policy." Furthermore, Congress has given the corporation authority to build three government-owned plants to serve as prototypes for private industry.

Although the corporation exists on paper, in fact it still waits the first breath of life through presidential nomination and senatorial approval of a seven-man board of directors. However, the Department of Energy, holding the purse strings on the major portion of $8 billion not allocated to the Synthetic Fuels Corporation under the Energy Security Act, has already begun to distribute vast sums of money to companies around the country. In July alone almost $200 million was awarded for various synthetic fuel projects. One hundred million dollars of it has been allocated for "feasibility studies" to determine potential technologies that can be utilized. The remaining $100 million has been allocated for preconstruction and construction costs to assist firms in Arkansas, California, Florida, Kentucky, Michigan, North Carolina, North Dakota, Ohio, and Wyoming in building synthetic fuel plants.

Given the known availability of the resources to produce the synthetic fuels and the existence of already significant technological knowledge about the requisite conversion process, why hasn't the private sector, on its own initiative, begun to exploit these energy alternatives?

Proponents of the government's energy program usually focus on two points: first, American dependency on foreign oil has reached such a critical stage that any breaking off or slowing down of that foreign supply could have catastrophic consequences for the U.S. economy. Hence, as quickly as possible America *must* become "energy independent." It is claimed that private enterprise's own response would be "too slow." Second, it is argued, the large sums of capital necessary to convert to synthetic fuel substitutes make it highly unlikely that private enterprise would have either the willingness or the capacity to take on the job itself if unassisted by the government.

One of the primary characteristics of a free-market economy (and one admitted even by most of its critics) is its adaptability to changing conditions. Profits are earned and losses are avoided precisely by a willingness on the part of those in the market to shift from activities that show relatively little profit to those that appear to promise rising profits. As economists express it, bygones are bygones. That costs and expenses were incurred in the building of an existing plant and equipment does not in any way assure that selling prices for the products produced will cover those costs. Attempts to persevere with existing methods in the face of changes in supply and demand only guarantee even greater losses (as the automobile industry has recently found out). In a market economy only alert adaptation to new circumstances can transform potential financial disaster into sizable monetary gain.

On the other hand, in governmental activities there exists nothing analogous to the profit incentive to bring about the appropriate adjustments to new conditions. It is impossible to imagine private firms debating for five years as to whether a "synthetic fuels corporation" should be formed, if eco-

(Cont. on p. 8)

Trade Regulations/FTC Watch

The FTC has asked the General Accounting Office for clearance to send out a questionnaire to state bar associations. The purpose of the questionnaire is to investigate prepaid legal plans and legal clinics so that the FTC can issue regulations in these areas. It is estimated that the form will take 70 hours to complete.

One of the largest civil penalties in the history of the FTC—$440,000—has been levied against four steel makers to settle charges of price fixing. The FTC ruled that United States Steel Corp., Bethlehem Steel Corp., Laclede Steel Co., and Armco Steel Corp. had violated a 1951 FTC mandate by fixing prices and dividing up markets. The complaint, filed in 1977, also alleges that the four companies were guilty of collusive bidding on contracts.

The antitrust divisions of the Massachusetts, Vermont, and Rhode Island state governments have filed class action suits against several art supplies dealers on the charge of price fixing. Crayons, paints, and brushes are among the items at issue. Since Vermont also filed a charge with the FTC, the offending firms may have to pay treble damages as well as the state's charge of $10,000 per violation. Rhode Island is asking for $50,000 per violation of state law.

The FTC has ruled that bankers seats on the boards of directors of two oil-field-service companies, Hughes Tool Co. and Big Three Industries Inc., are in violation of the antitrust rule prohibiting interlocking directorates.

Several new amendments to the FTC's wool product labeling regulations have been announced. The FTC said that the new regulations would require manufacturers of wool products to give the consumer a more detailed description of the content and nature of the product.

A magazine publisher has resisted an FTC "cease and desist" order by mailing out promotional items that resembled checks and other items of value. A ruling by federal district court in Delaware held that each individual mailing constituted a violation of the FTC order, and the publisher was fined $1.75 million.

The FTC has declared that it will consider price-restrictive cooperative advertising programs per se violations of the current body of antitrust law. The statement read in part, "Where an agreement, directly or indirectly, conditions cooperative advertising payments on a dealer's either advertising at not less than a specified price or advertising at discount prices, such a program tends to deter the effect of maintaining resale prices by alerting dealers that suggested minimum resale prices should be adhered to."

✓Washington Update

✓President Carter has signed a recent bill, the Soft Drink Interbrand Competition Act, that would exempt soft drink territories from rigid antitrust scrutiny, thereby allowing greater use of trademark and licensing agreements with territorial restrictions attached. The bill eliminated the legal proceedings that have been pending against the soft drink industry since 1971. President Carter emphasized that the bill does not constitute an exemption from the antitrust laws.

✓The House Committee on Small Business has cleared a bill that would prohibit major integrated oil refiners from directly operating retail gasoline stations. Although the refiner would still be allowed to own the station, it would have to run the station through a lessee dealer. The bill also contains a clause that prohibits oil refiners from practicing price discrimination.

✓A U.S. court of appeals has ruled that tax collectors need not comply with the Fair Debt Collection Practices Act when trying to collect overdue taxes. As a result, taxpayers may be subject to harassment and fraudulent threats at the hands of the IRS. In one case, a collection agency hired by the state government sent taxpayers a notice that threatened to sell their homes and confiscate the revenue.

✓The Job Corps of the Labor Department has come under attack for wasting millions on youth employment training centers. Recent projects include $1.8 million spent on a training center in Chiniak, Alaska, which has been abandoned because of a lack of proper housing, and $1 million for a center in Donaldson, Indiana, a project that has been placed on indefinite hold. Three million dollars spent on a proposed center at Bethel, Minnesota, has been lost because of local opposition to the project.

✓By a vote of 60 to 31, the Senate has approved President Carter's standby gasoline rationing plan, thereby enacting it into law. The plan gives the President power to impose rationing if there is a shortage of gasoline of 20 percent or greater. If the standby plan is invoked, gasoline will be meted out on the basis of the severity of the shortage and the number of vehicles at a given house or business. It is expected that the average household would receive approximately 42 gallons of gasoline a month, depending upon what state it was in. "Priority" users, such as farmers or certain businessmen, would get additional coupons. Ration coupons would be handed out at gas stations at the time of gasoline purchases.

✓Only four months after predicting a substantial budget surplus for 1981, the Carter administration has officially estimated that next year's budget will have a deficit of $29.8 billion. This estimate should not be taken too seriously, however, because as recently as March the White House had predicted that this year's deficit would be $36.5 billion. It is now $60.9 billion, the second largest deficit in American history. Interest on the 1981 national debt will cost more than $80 billion, approximately 13% of federal spending.

✓It will cost the federal government $3.1 million this year to run the White House for President Carter, a 17% increase over last year. This figure does not include the $855,100 required to maintain the gardens and grounds.

✓On August 1, House and Senate conferees approved a $52.8 billion weapons bill. The outlay will primarily cover an 11.7% pay increase for the armed forces as well as the construction of a new bomber.

✓The Interstate Commerce Commission has issued its first rulings in a comprehensive plan to partially deregulate trucking. The rules include an easing of requirements for motor carriers seeking approval to operate, an increase in the freedom for a company to haul for corporate affiliates, and a speeding up of the time for processing and handling applications for mergers and acquisitions.

✓Federal statisticians have uncovered more than 29,000 workers in over 100 bureaus who do nothing but produce statistics for government programs. These employees cost taxpayers approximately $1 billion a year. ■

Synthetic Fuels (Cont. from p. 5)

nomic circumstances warranted it. Nor is it likely that an entrenched bureaucracy would willingly dissolve particular projects or enterprises if their financial soundness came into question. The chance is greater that the "political" would take precedence over the "economic," and industrial structures long past their social usefulness would continue to absorb the society's (i.e., the taxpayer's) resources.

Nor does the argument that the costs are too great for private enterprise to do the job hold up to critical analysis. In recent years firms in the private sector have initiated, either on their own or in joint ventures with other companies, projects whose capital expenditures are certainly equal to the outlays that would be required for investment in energy alternatives. Examples of such projects are large chemical plants, oil refineries, supertankers, and the Alaskan pipeline (the latter costing approximately $4.5 billion).

All of these ventures were (and are) undertaken precisely because investors perceived that profit opportunities far exceeded the outlays involved. Individuals risking their own capital utilized their direct and specialized knowledge of the market in question to make a judgment that expenditures of

those magnitudes were justified in terms of anticipated selling price.

Why, then, haven't these investments been undertaken for the production of synthetic fuels? Because technological *capability* is not equivalent to economic *feasibility*. In terms of the market prices potential investors have anticipated for oil produced from coal, shale, tar sand, etc., production hasn't been worth the cost.

Although the market price of oil has gone up, so have the costs of extracting oil from these resources. For example, according to the Rand Corporation the costs of deriving oil from shale climbed steadily during the 1970s. In 1972 shale oil would have been profitable at $6.60 a barrel—then three times the price of imported oil. In 1975 foreign oil sold for $12 a barrel; however, shale costs were projected at $21 a barrel. And in 1979 shale oil extraction was estimated at $25 a barrel, or approximately $5 above the world oil prices. (The unprofitability of synthetic fuel production has, of course, been made even greater by the continuing existence of domestic oil price controls that distort the market price structure and create disincentives for *all* forms of energy resource development.)

Another factor that must be considered is investor expectations about the government's energy policy. For five years debate went on in Congress over whether the synthetic fuels program should be implemented. To the extent that companies held more or less strong expectations that the program would be passed, they probably postponed or diminished any planned research and experimentation with synthetic fuel. Believing that federal subsidization and underwriting of many of the costs involved was just around the corner, companies may have slowed down the very activities the government was so interested in fostering.

The crucial difference now, however, is that a sizable portion of the costs of experimentation and construction may be borne by the taxpayers rather than by the companies involved. It should not be surprising, therefore, that hundreds of companies and corporations have come to the government's door hoping for a chance to receive a part of the latest "transfer payment" program instituted by Congress. (For example, the 110 "alternative energy" projects that the Department of Energy approved in July and for which it distributed $200 million, were selected from 971 proposals submitted by private firms.)

> **"It is estimated that recoverable coal deposits in America are equal to 1 trillion barrels of oil, and shale deposits represent 600 million to 1 trillion barrels of oil."**

Important changes, however, are now likely in both the form of the investments and the financial risks that will be taken. No longer will experimentation with energy alternatives be guided purely by anticipation of consumer willingness to pay prices that will cover the costs. Instead, firms will be guided by what they believe will be most salable to the respective government agencies involved.

Indeed, a project that may have no conceivable economic viability either now or at any time in the foreseeable future will suddenly become "profitable" purely because it is what will "sell" at the Synthetic Fuels Corporation or the Department of Energy. Just as the Entitlement Program created an entirely artificial segment of the oil refinery industry (by requiring large oil refineries who have access to relatively less expensive crude oil to pay subsidies to higher-cost, small refineries), the Energy Security Act is almost certainly going to generate artificial industries in the alternative energy field. As *Barron's* recently quoted one Capitol Hill "veteran" as saying, "Not every Congressman can get a dam in his district. With synfuels, anybody can get a plant of some kind, even the inner-city Congressman who can get a waste-to-energy plant now." And as Daniel Denny, a Gulf Oil official, admitted, "People will be coming out of the woodwork going after the money."

The crucial guide in deciding among investment opportunities is the expected price that one will receive for the product produced from that investment. Expectations about *future* prices are critical in planning *present* investments and research projects.

Yet not only does the Energy Security Act lower the present costs of synthetic fuel projects through loans and loan guarantees for the budding firms in the industry, it also weakens the concern those firms might have about the potential future market for their product. Through a program of purchase agreements, if the firms find that after incurring the cost of building plants capable of producing synthetic fuels the prevailing market price is below their production costs, the government will buy their output at an above-market price and then sell it back on the market at a loss.

This procedure breaks all links connecting the industry with the market. Indeed, through the purchase agreements the government lifts the industry totally out of the market—away from all the market disciplines that are supposed to restrain waste and extravagance on the one hand and stimulate consumer-oriented entrepreneurship on the other hand.

What becomes vital for an industry's maintenance and growth in this situation is political entrepreneurship: the ability on the part of those in decision-making positions to judge what is most likely to appeal to the political and bureaucratic distributors of

government programs. It is a situation concisely described by the Austrian economist Ludwig von Mises:

> In the interventionist state, it is no longer of crucial importance for the success of an enterprise that operations be run in such a way that the needs of the consumer are satisfied in the best and least expensive way; it is much more important that one has "good relations" with the controlling political factions, that the interventions redound to the advantage of the enterprise.... It is much more important to have "connections" than to produce well and cheaply. Consequently, the men who reach the top of such enterprises are not those who know how to organize operations and give production a direction which the market situation demands, but men who are in good standing both "above" and "below," men who know how to get along with the press and with all the political parties.... This is that class of general directors who deal more with federal dignitaries and party leaders than with those from whom they buy and to whom they sell.

It is obvious from Mises's remarks (made about the Weimar Republic just before Hitler's takeover) that any economy operating along such lines is verging on economic fascism. Production is no longer guided by expectations of consumer demand, least-cost methods of production, or free competition; rather, it slips into the realm of government-industry "planning." The location of industrial sites, the form and quantity of products supplied, and the prices at which the producers can expect to sell their products are all now determined politically.

That the Synthetic Fuels Corporation and its activities fall into the arena of economic fascism should be evident from the analysis given above. In fact, Representative Robert E. Bauman (R-MD) declared, in his opposition to the Energy Security Act, that the legislation was "fascism, pure and simple." In the other house of Congress, Senator J. Bennett Johnston (D-LA), a leading proponent of the act, declared that its purpose was to plant the synthetic fuel industry "in a government hothouse so that these little seedlings will grow strong and tall." Senator Johnston went on to say that the act was a necessary step toward a "Japan, Inc." form of partnership between government and industry in the energy sector.

Although resources capable of producing synthetic fuels exist in abundance, they have remained unused for this purpose primarily because the costs have been seen to be greater than the benefits. Simply put, under present market conditions synthetic fuel production involves economic waste.

The government's drive to sponsor, induce, and bribe synthetic fuel investment is nothing less than a slap in the face to economic reality. The result can only be a displacement of private production planning based on consumer satisfaction at least-cost prices by government-induced production planning guided by political considerations.

What is economically efficient and viable is not a "given." It changes over time and is dependent upon shifts in consumer demand, depletion of some resources, and the discovery of others. The Synthetic Fuels Corporation and the continuing system of price controls on oil production can, therefore, succeed only in handicapping any attempt on the part of market-oriented entrepreneurs to devise methods to meet any energy shortages that might arise. The free market is the solution, not the Energy Security Act. ■

GOVERNMENT SPENDING MONITOR

A quarterly feature of *Policy Report*, the "Government Spending Monitor" summarizes the latest expenditures by local, state, and federal governments.

EXPENDITURES (annual rate in billions of $)

	1980 Second Quarter	1980 First Quarter	1979 Fourth Quarter	Average for Last Four Quarters
Federal Government	579.0	561.3	540.4	549.2
State and Local Government	334.5	331.0	322.8	325.8
Total Government	913.5	892.3	863.2	875.0
Federal Transfer Payments	236.1	230.0	222.7	226.6
Defense	71.5	67.7	63.0	65.6
Aid to State and Local Governments	86.4	86.0	84.3	84.6
Compensation Paid to Federal Employees	82.2	81.2	80.6	80.0
Federal Interest Paid	66.5	61.8	57.5	47.9
Federal Surplus or Deficit	−69.9	−61.2	−5.6	−43.1
Reported Federal Debt	877.3	856.1	836.1	846.3
Total Government Employment, All Levels (millions)	16.2	16.2	16.0	16.1

Source: National Bureau of Economic Research.

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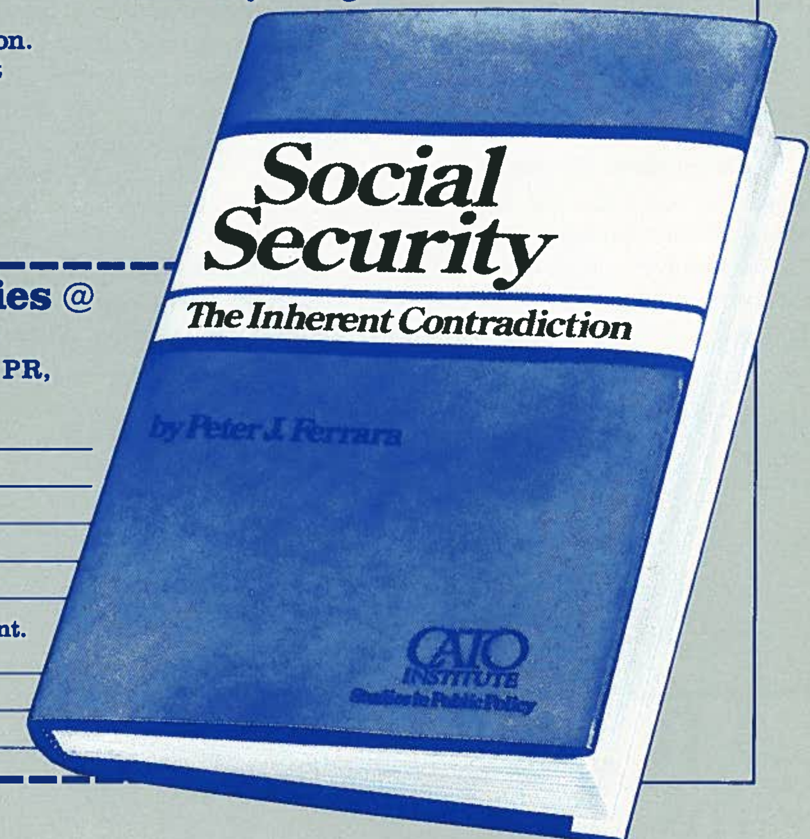

"To be governed . . ."

Point, counterpoint — part 1

The National Highway Traffic Safety Administration mandates weight-adding safety equipment for cars.... The Transportation Department is insisting on lighter vehicles to conserve gasoline.

—*Business Week*, June 30, 1980

Point, counterpoint — part 2

The Environmental Protection Agency restricts use of pesticides.... The Department of Agriculture encourages pesticides for agricultural and forestry uses.

—*Business Week*, June 30, 1980

Could you please repeat that last statement?

With three lawmakers under indictment in the Abscam scandal and five others facing possible charges, Congress confronts a new test of its ability to police its own membership.

"The level of ethical conduct [of Congress] is high. If you are talking about integrity where money is concerned, it probably has never been higher." — Senator Adlai Stevenson Jr.

—*U.S. News & World Report*, June 23, 1980

Well worth the effort

Someone reported [a] 12-year-old fishing-bait entrepreneur in Eddyville, N.Y., to the New York State Department of Taxation and Finance; he wasn't paying sales taxes, the informant said. The department sent Jody a letter in July 1979: pay up or else.

Jody was sick for a week, worried that the state would seize his bicycle and boat for nonpayment of taxes.

The department dispatched two agents and collected all 64 cents due.

—*New York Times*, Aug. 3, 1980

Give till it hurts

Some Congressmen opposed to the Occupational Safety and Health Administration have found a way to use the agency for their own ends. The lawmakers got data under the Freedom of Information Act on firms accused of violating OSHA rules, then asked those businesses for campaign contributions with the promise to fight in Congress to kill the agency.

—*U.S. News & World Report*, June 28, 1980

Monkey see, monkey do

Not all lawmakers were unhappy over reports of how members of Congress spend taxpayers' money from their expense accounts. Some privately said they learned about practices they never knew were permissible, such as treating voters to meals, and leasing or renting cars back home.

—*U.S. News & World Report*, June 30, 1980

Now that's what I call a politician!

Several years ago a car driven by Representative Jamie Whitten [D-MS] in the wealthy Georgetown section of Washington struck another vehicle, jumped the curb, hit an iron fence, grazed two trees and crashed through a brick wall.

"The first thing he did," said an astonished Mrs. Cabot Coville, owner of the demolished wall, "was get out of the car and begin shaking everyone's hand."

—*New York Times*, June 19, 1980

They may be slow, but...

According to *Sex Care Digest*, a $10,000 study of the sex life of the loggerhead turtle has been ordered — reluctantly — by the city council of Danville, West Virginia, on the insistence of the Environmental Protection Agency, which has been objecting to pollution from the city's coal-burning steam plant. The study, which will free the city from a fine for pollution, supposedly will reveal the effects of fly ash on animal life."

—*Players*, August 1980

McCarthyism hits the tarantula crowd

"Tarantulas," says Edward Kittredge, a customs spokesman in Washington, "would be classified as 'other live animals.'" They are duty-free in any case, he notes, unless they are Communist tarantulas. Those from the Soviet bloc are subject to a 15 percent tariff on their value.

—*New York Times*, July 23, 1980

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