

POLICY REPORT

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The Education Tax Credit Proposal

by E. G. West

It's just the kind of proposal to appeal to Ronald Reagan. First you create a big new federal responsibility to drain billions from the Treasury. Never mind all that talk about a balanced budget. . . . What you want is a new, controllable revenue loss that doesn't address any national problem.

Then you want to make sure that this initiative intrudes deeply into state authority, that it doesn't chiefly benefit the "truly needy," and that it raises the prospective threat of more regulation of the private sector. But above all, you want to make Washington responsible for something long considered none of its affair: subsidizing attachments to religious and ethnic groups.

Noel Epstein and Marshall S. Smith,
Washington Post, 12 April 1981

The noise being created these days by those who oppose tuition tax credits provides an excellent illustration of how throwing a bucket of paint on a worthy idea can help to depict it as its very antithesis.

Oversimplified as it is, the attack of Messrs. Epstein and Smith easily lends itself to dissection and refutation.

" . . . big new federal responsibility . . . "

If by "responsibility" the authors mean the voluntary commitment by the federal government to promoting certain goals in American education, and by "new" they mean to suggest that the federal government has rarely before used its powers to

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achieve such goals, one can only wonder what the rationale was for passage of the National Defense Education Act of 1959, the Vocational and Adult Education Act of 1963, the Elementary and Secondary

"What education tax credits seek to enhance is not governmental responsibility but parental freedom of choice."

Education Acts of 1965, the Education of the Handicapped Act of 1970, the Indian Education Act of 1972, and the plethora of programs that have provided financial aid to college students and the schools they attend—Basic Educational Opportunity Grants, National Defense Student Loans, Guaranteed Student Loans, veterans' benefits, etc.

The federal government has been involved in education ever since it passed the Morrill Act in 1862, which established land-grant universities in many states on the condition that they offer instruction in agriculture and the mechanical arts. Education, therefore, is hardly a "new responsibility."

What education tax credits seek to enhance, however, is not governmental responsibility, but parental freedom of choice. The federal government would not be charged with a new obligation either to finance or to regulate private schools—indeed, most tuition tax credit proposals adamantly oppose any increase of government intervention into private education.

" . . . to drain billions from the Treasury."

Even a brief examination of the economics of education tax credits reveals the concept's enormous tax-saving potential.

In 1977-78, 43,731,000 students were enrolled in U.S. public schools, and 5,095,000 attended private schools. The public schools were spending \$1,736 per student annually, or \$917 more than the \$819 per head spent by the private schools.

The Packwood-Moynihan Tuition Tax Credit bill—which attracted 50 cosponsors in the Senate before it was derailed by Carter administration supporters in the final days of the 96th Congress—proposed tax credits that would have reimbursed parents about half the cost of tuition. (A revised Packwood-Moynihan bill has been introduced in 1981.)

Suppose, then, that the government had offered a tax credit in 1978 equal to one-half the average private school expenditure per student that year—one-half of \$819, or \$409.50. If there were zero pupil transfers from public to private schools, the cost to the authorities would have amounted to more than \$2 billion—indeed a drain on the Treasury.

But suppose that this tax credit prompted a mere 5% of the public school population (or 2,186,550) to switch to private schools. The authorities would no longer be paying \$1,736 per year for each of those students, but \$409.50, assuming that entry into private schools is fairly open and that the scale of operations is such that the additional cost of another student is close to the average cost. Multiply this per-student savings of \$1,326.50 by 2,186,550, and we find net government savings to be more than \$2.9 billion.

A tax credit based on one-half the cur-

(Cont. on p. 2)

EDITORIAL

Whatever Happened to the American Dream?

A San Francisco department store carries a set of high-ball glasses with 11 years of Dow-Jones averages depicted on the side. A brief examination of the glasses conjures up some interesting thoughts about what those numbers mean for the American economy and the average American.

The figures began in 1967. The Dow-Jones Index closed at 850 on 31 January. Eleven years later, on 31 January 1978, the index was 770. That means that an American who invested \$850 in the stock market in January 1967, if his investments paralleled the market as a whole, would have had only \$770 by 1978.

The loss is really much greater than that, of course. Because of inflation, the buying power of his \$770 in 1978 was equivalent to only \$406 in 1967 dollars.

What this means is that an American who invested a portion of his savings directly into American industry in 1967 lost half of his investment by 1978.

But perhaps that 11-year span is an atypical one. What has happened since 1978? In June 1981 the Dow-Jones average stood at about 950. If our mythical average American had invested \$770 in the stock market in 1978, he would have seen his investment increase to \$950 three-and-one-half years later. Not a bad return, right? Well, in fact, that \$950 has the buying power of only \$656 in 1978 dollars. Thus he has actually lost 15% of his investment.

There was a time in America when the average worker could save a few dollars out of his paycheck, invest it in America's great industrial enterprises, and see his investment grow. At some point in the future, he might have accumulated enough to send his children to college or to provide for a comfortable retirement. Today, that avenue to modest wealth is closed off for most Americans. Of course, a shrewd investor, picking the right companies and calling the market properly, can still make money in the stock market. But most of us are not shrewd investors, and it ought to be possible to get a decent return on one's investment in major American companies without being one.

What has changed? The continuing anemia of the stock market has two major causes. First and most obvious is the double taxation of corporate dividends. With tax rates as

high as they are, double taxation is clearly a prohibitive burden for most people. It strongly discourages investments in the stock market.

The less obvious reason is the declining value of property ownership in America. Businesses are subject to more and more restrictions, regulations, and controls by government. Real profits (as opposed to paper profits created by inflation) are harder and harder to come by in many industries. The restrictions on entrepreneurs limit their freedom more and more. When the rights of ownership are taken away, the value of ownership declines. And since a share of stock represents a share of ownership in a company, the value of such shares declines along with the value of ownership.

Today, the average American finds himself or herself increasingly unable to "get ahead." Money saved depreciates at the rate of about 10% a year. Young couples find themselves unable to afford a house at current prices and interest rates. Even the interest on savings accounts is limited for the small investor (although the legalization of money-market funds has eased this problem to some extent). The social security system gives the appearance of being a secure investment for one's old age, when in fact the money paid in this year is paid out only a few months later, and there is no contractual obligation on the part of the government. And should he or she decide that there's no future in working for wages when his modest investment opportunities are so dismal, our American will find that entry into 850 different occupations is restricted by licensing laws—and those not restricted are so hard-pressed by taxes and regulations that making a profit is inordinately difficult.

The federal government has effectively closed off the American dream. The average American can no longer accumulate a nest egg by any of the traditional means. When Americans realize what government intervention in the economy has done to them, there may be a popular movement for laissez-faire on a scale not seen since Jacksonian days, when average working people realized that government intervention almost always worked against them. It could be the biggest change in American politics, and economic policy, in generations. ■

Tax Credit (Cont. from p. 1)

rent average operating expenditure per student in the private sector would begin to generate substantial savings after only 5% of the public school population had transferred to private institutions. A recent nationwide poll conducted by *Newsweek* (20 April 1981) indicated that 23% of parents with children in public schools say they would probably switch to private schools if Congress approved tuition tax credits of \$250-\$500 a year.

Taxpayers who do not have children would especially welcome this change. And those who do have school-age children should enjoy the reduction in taxes and the greater freedom of choice in their own children's schooling.

What's more, there are numerous precedents for tuition tax credits. Several forms of tax deductions and credits similar to those proposed already exist. Expenditures for education are already tax deductible under certain conditions, as when necessary to reemployment, required by one's employer for retaining one's job, or demanded for the maintenance of one's professional competency. Sixty percent of the return on a capital investment is already deductible, and education may certainly be regarded as a capital investment.

Ironically, contributions for the support of private educational institutions also are allowed—except when payments are made in the form of tuition for one's own offspring. Payments by employed parents to private babysitters for the care of preschool children are tax deductible—until the children come of school age.

"... doesn't address any national problem."

Public high schools are graduating functional illiterates, SAT scores have been plummeting for years, school-board referenda have been voted down throughout the country, the number of students and teachers assaulted and even murdered in schools is increasing—and we don't have a national problem?

The inefficiency of public schools is perhaps to be expected, given the monopolistic system under which they operate.

Their performance contrasts sharply with that of private schools. The much discussed *Coleman Report*, made public earlier this year by the National Center for Education Statistics, confirms that "private schools provide a safer, more disciplined, and more ordered environment than do public schools." There is every reason to expect that if tuition tax credits are enacted, a healthy competition will be fostered between private schools and the public schools now largely unaccountable either to students or parents.

"... intrudes deeply into state authority..."

Any authority over education the states may claim to have has been usurped from local governments in the past few decades. Early American schools were organized at the community level and placed under the direction of popularly elected school boards. Few states had their own departments of education until the early 1950s, and most of them were small, unorganized, and concerned primarily with compiling and publishing educational statistics. Eventually the exercise of regulatory functions and a direct hand in policy making were added. Today, to varying degrees, state educational authorities backed by powerful teachers' unions are able to preempt local decision making, withhold federal funds from local school districts, and obstruct local economy measures that would reduce teaching staffs in response to declining enrollments.

Any legislation that would increase parental freedom of choice and increase competition between private and public schools would most benefit those children who are presently the victims of this country's disastrous public school system. Whether this legislation steps on the toes of the National Education Association or of bureaucrats in state education agencies is another matter.

(Incidentally, Noel Epstein is a former education editor of the *Washington Post* and is an assistant "Outlook" editor on the *Post*; Marshall S. Smith is a former assistant commissioner of education, and now teaches education policy at the University of Wisconsin.)

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Tax Credit (Cont. from p. 3)

"...make sure it doesn't benefit the 'truly needy'..."

Senator Ernest F. Hollings (D-S.C.) has opposed tuition tax credits with the statement that it is wrong to relieve the financial pressure on independent schools because they are typically selective and simply serve those families who are fleeing from the inner-city, integrated schools. "The public school, in contrast," Hollings said, "must take all comers—regardless of background, regardless of special problems."

Hollings's two-pronged attack—that private schools are both elitist and racist—cannot stand up to an examination of the demographics of private-school enrollment. Any independent school should be evaluated against the income and racial composition of other schools in its area.

In California, where important constitutional initiatives are underway to establish education vouchers or tax credits, the percentage of minority students in private schools—22.1%—is not much different from the 27.3% in public schools.

In addition, the *Coleman Report* stated that because tuition tax credits would facilitate the use of private schools, they "would not increase segregation along racial or economic lines but would decrease it. . . . Such policies would bring more blacks, Hispanics, and students from lower-income backgrounds into private schools."

As for the charge that private schools cater to affluent families, Bureau of the Census figures show that family incomes of private-school students are more similar to the income distribution patterns for the whole United States than is often believed. Although it is true that a greater proportion of the public-school population came from families with incomes of less than \$10,000 in 1974 (35% versus 20%), private schools derived 6% more of their population than did public schools from the next income group (\$10,000–\$15,000). Finally, in the highest income groups (more than \$25,000), private schools enrolled only 2.5% more than did public schools.

"...make Washington responsible for something long considered none of its affair: subsidizing attachments to religious or ethnic groups."

Opponents of tuition tax credits usually trot out the argument that the credits would violate the First Amendment's "es-

"Contributions for the support of private educational institutions are tax-deductible—except when payments are made in the form of tuition for one's own offspring."

establishment clause," which prohibits government from making laws "respecting an establishment of religion." But leading constitutional scholars have traditionally maintained that the establishment clause was originally intended to be a safeguard against the establishment of any particular religious sect and was never intended to mean that government could not give encouragement to religion in general.

An interpretation of the First Amendment that absolutely excludes religion from the political life of the nation contradicts an important point made by George Washington in his Farewell Address:

Of all the dispositions and habits which lead to political prosperity, religion and morality are indispensable supports. In vain would that man claim the tribute of patriotism who should labor to subvert these great pillars of human happiness.

Edwin S. Corwin, one of the most distinguished constitutional scholars, notes:

The historical record shows beyond peradventure that the core idea of an "establishment of religion" comprises the idea of preference; and that any act of public authority favorable to religion in general cannot, without manifest falsification of history, be brought under the ban of that phrase.

The free-exercise clause states that Congress shall make no law "prohibiting the

free exercise" of religion. The fact is, however, that a system that taxes everybody to support a public school system *prohibits in degree* the ability of those parents who normally patronize a parochial school. Under such a system, whenever the parent chooses a parochial school, he forgoes the opportunity to receive a "free" education in the public sector. The forgoing of this opportunity, to the economist at least, is the very essence of the word "cost."

Although Epstein and Smith would like to portray tuition tax credit proposals as perverting the new conservative creed, tuition tax credits represent a true market solution to the problems of public education. What's more, they have been advocated in the United States for almost 200 years.

Thomas Paine, in *The Rights of Man*, published in 1792, called for the remission of excise taxes (there were no income taxes in his day, of course) to enable people to purchase education in private schools.

With all due respect to Epstein and Smith, education tax credits are the very embodiment of a free society. That the Reagan administration and many members of Congress support the proposals should come as no surprise. That the National Education Association and members of the education establishment should oppose them is to be expected. If liberals dismayed by the prospect of tuition tax credits can't stand the intellectual heat, they should get out of the seminar.

Coming in *POLICY REPORT*

Tom Hazlett on antitrust and price-fixing

Brian McAndrew on econometric models

David Henderson on the Department of Labor and the home/work rule

Robert L. Formaini on noise pollution

Eugenie Dudding Short on financial activities in free-enterprise zones

Economic Liberties and the Supreme Court

by Tyler Cowen

The Supreme Court has been the subject of much attention in recent months, particularly because of its ruling on the draft and President Reagan's appointment of the first woman justice. Each of these events was controversial. The court's ruling upholding the constitutionality of male-only draft registration was criticized by feminist groups who saw it as a blow to women's rights and by civil libertarians who had hoped the Court would strike down registration. Reagan's nomination of Sandra O'Connor raised a storm of protest from right-wing and religious groups who charged that it violated Reagan's campaign pledge to appoint justices opposed to abortion.

Despite all of this controversy, there is one aspect of the Supreme Court's 1980–81 term that has neither received sufficient national publicity nor raised a significant cry of protest—the Court's rulings on economic issues. Most people think that the Court rules primarily on issues of civil liberties, but its rulings on matters of economic freedom are also of vital importance to both our personal freedoms and our economic prosperity. In fact, economic freedom and civil liberties are not two different spheres of human activity, but rather two sides of the same coin. Supreme Court rulings that interfere with one are likely also to infringe on the other.

For instance, let us examine two of the Supreme Court's major rulings in its last term. In the first ruling the Supreme Court upheld the right of federal safety and health inspectors to enter and check mines and stone quarries without search warrants. On the one hand this can be viewed as a violation of economic liberties, since the federal inspectors may very well be challenging working conditions that both the employer and employee voluntarily agreed on. On the other, it is also clearly a violation of civil liberties. (Imagine the

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outrage that would occur if police were allowed to search a criminal suspect's

"Supreme Court rulings that interfere with economic freedom are also likely to infringe on civil liberties."

home for evidence without a search warrant.) The workplace is an employer's rightful property, and any forcible transgression against his property rights, with or without a search warrant, should be considered wrong.

In the second ruling the Court held that federal laws that prohibit the placing of unstamped mail in private mailboxes do not violate the first-amendment right of free speech. Although this decision could rightfully be criticized on first-amendment grounds, it also upholds a violation of our economic freedoms in that it discourages private mail-carriers from competing against the government-supported postal monopoly. Violation of civil liberties? Violation of economic liberties? Or violation of both?

With other Court decisions the justices have used a misapplication of the principle of civil liberties in order to restrict economic freedom. For instance, the Court has ruled that in order to uphold religious freedom it will allow workers who quit their jobs because of religious beliefs (e.g., a religious pacifist who is asked to work on a military-related project) to collect unemployment insurance just as if they had been laid off. Such a ruling clearly diminishes economic freedom both by extending the clutches of the welfare state and by implicitly supporting and extending the coercive, tax-financed benefits and appa-

ratus of the unemployment compensation program. Religious freedom is not the relevant issue here since the right to worship freely refers only to the right to be free of external coercion in matters of religion. It does *not* give an individual the right to force others to subsidize him for any financially damaging consequences his beliefs may engender.

An examination of the recent rulings of the Burger Court reveals that in the vast majority of cases the Court has ruled *against* economic freedom. A few examples are in order. Earlier this summer the Court had ruled that the Federal Communications Commission has the power to force television networks and stations to sell prime-time advertising to either presidential or congressional candidates whether or not the station wishes to cede the time. The decision (*CBS v. FCC*, 80-207) arose out of a 1979 dispute over the FCC's ordering the three major networks to air a political advertisement on behalf of ex-President Carter. The networks had initially refused the request for time, contending that the presidential campaign had not yet begun, but they were overruled by the FCC. Eventually the case reached the Supreme Court, which ruled by a margin of 6-3 in favor of the FCC, citing a 1972 statute that granted to all qualified candidates for federal office the right to "reasonable access to the use of (broadcast) stations" for paid political broadcasts. The statute also mandates that any station or network that engages in "willful or repeated failure" to observe this provision may have its license revoked by the FCC. In the opinion written by Chief Justice Warren Burger, the Court said that the political candidate's right to free speech and the public's right to information were such important overriding factors that the broadcasters' first-amendment rights were of negligible importance. There was no mention of the station's right to use its own property to

broadcast freely without outside interference. Even the National Association of Broadcasters, which issued a statement criticizing the Court's ruling, defended the networks' position only on first-amendment grounds, not from a philosophy of economic freedom.

The Court has produced several equally harmful rulings on federal regulatory activity. For instance, the Court upheld safety and health standards that were about to be imposed on the textile industry in order to safeguard workers from exposure to cotton dust, a toxic substance that can cause brown-lung disease. Not only did the justices approve these standards, they ruled that federal regulators do not have to justify them by a cost-benefit analysis. Before the ruling, Reagan had directed OSHA to ask the Supreme Court to hold off its decision on the standards because the agency was considering withdrawing the regulations for possible review or even revocation. This action led to a flurry of protests from organized labor, which began a series of Monday night vigils on the steps of the Capitol as well as a series of mass protest actions that reached their peak in May (the OSHA request came on March 27). The Court ignored OSHA's request and simply issued its decision. This issue had been unresolved for over 10 years, during which time textile manufacturers had to decide whether they should start retooling in order to meet the March 1984 compliance date for the new standards. Many manufacturers came to favor an immediate passage of the standards, either to alleviate their uncertainty or because they had already progressed further than their competitors in meeting the standards.

Another important regulatory ruling by the Court during its 1980-81 session was on lead exposure standards for workers. In 1978 OSHA had issued a sweeping set of lead exposure standards, partly as a result of pressure from the United Steelworkers. Industry estimates place the cost of compliance with these rules at approximately \$1 billion over the next 10 years. In 1980 a District of Columbia appeals court admitted that it could be sure that these

standards were economically feasible only for the biggest potential manufacturers in certain industries (primary and secondary lead smelters and battery manufacturers). The dubious future of many smaller companies under these regulations had led to

"The Court has been more instrumental in accelerating the erosion of our economic liberties than in protecting them."

literally hundreds of lawsuits, all of which were dismissed by the Court's ruling in late June that the standards were justifiable—a decision issued without comment or statements.

Pollution is another sticky issue involving both economic and ethical questions, and it has been mishandled by the Court. In a free society there would be no direct government regulations on pollution. Any individual whose property or person was damaged by pollution could take the polluter to court and institute either a common-law tort or class-action suit. In just one term the Court has taken two steps in the wrong direction on this issue. The Court ruled in the case of *Middlesex County Sewerage Authority v. National Sea Clammers* (79-1711, 79-1754) that individuals who are demonstrably harmed by illegal water pollution (much less legal water pollution) cannot sue the polluters for damages under federal common law, the federal Water Pollution Control Act, or the Marine Protection Research and Sanctuaries Act. And, although on the one hand restricting justifiable individual recourse against pollution, on the other the Court expanded unjustifiable governmental recourse against pollution when it ruled that the Environmental Protection Agency need not consider the economic capabilities of businesses to meet any pollution standards that the EPA may decide to impose. Such a ruling will never produce a permanent solution to the

pollution problem but will only diminish productivity and serve to bankrupt business and industry. Government regulations on pollution are bound to be bureaucratic, inefficient, and heavy-handed. Only by letting the market process work through a common-law system can we determine what kinds of pollution can be stopped and at what levels they should be stopped.

Current public and professional perception of the Court is somewhat different from what this article may suggest, for the Court is rarely viewed as a systematic restrictor of economic freedom. Stephen Bokor, a legal aide to the United States Chamber of Commerce, summed up the prevailing attitude toward the Court when he noted that "it's pretty hard to say that this Court is probusiness or anti-business. It's all over the place."¹ This conclusion was echoed by law professor A. E. Dick Howard (University of Virginia) who said, "There's no grand design in the minds of these justices. They're making decisions on a pragmatic, case-by-case basis, so we're likely to see this crazy-quilt pattern of rulings continue."² These authorities cannot see any consistency in the Court's rulings because the Court has not been systematically favoring any particular interest groups. Instead, the underlying theme of the Court's rulings has been an erosion of our already insecure economic liberties.

Two more examples of the Court's recent actions show their damaging effect on economic liberties: "[The Supreme Court held that] women in jobs held primarily by women can sue on charges that their salaries are being discriminatorily held down. For the first time, the court said women can file and win wage-bias lawsuits *without proving that they perform the same jobs as men who get paid more.*" And, "Cities may ban billboards carrying 'commercial' advertising but apparently may not ban those billboards bearing political or other 'noncommercial' messages."³ (Emphasis added.)

All of these rulings illustrate a profound problem with the system of checks and balances that is supposed to limit the pow-

er of the federal government. Any high-school history textbook will tell you that by giving the Supreme Court the power to interpret the Constitution, the Founding Fathers placed a check over the executive and legislative branches of government, yet the Supreme Court implicitly serves another important function, one usually not mentioned in high-school texts. If we give the Court the power to strike down legislation on the grounds that it is unconstitutional, then we are also giving the Court the power to *approve* legislation, thereby making the Court *the ultimate legitimizing agent of government actions*. Once the justices have voted in favor of maintaining or expanding governmental power, there can be no further challenge to such a ruling. Individuals have no recourse to any other institution but must accept the Court's decision as final and unalterable. It was through such a process of judicial approval that many Americans came to accept the New Deal, and it is through the same process that government agencies such as OSHA have gained their strong foothold. This point about the New Deal has been well summarized by Charles Black: "The standard version of the story of the New Deal and the Court, though accurate in its way, displaces the emphasis . . . It concentrates on the difficulties; it almost forgets how the whole thing turned out. The upshot of the matter was . . . that after some twenty-four months of balking . . . the Supreme Court, without a single change in the law of its composition, or, indeed, in its actual manning, placed the affirmative stamp of legitimacy on the New Deal, and on the whole new conception of government in America . . . Of course, not everyone was satisfied. The Bonnie Prince Chaplie of constitutionally commanded laissez-faire still stirs the hearts of a few zealots in the Highlands of choleric unreality. But there is no longer any significant or dangerous public doubt as to the constitutional power of Congress to deal as it does with the national economy . . . We had no means, other than the Supreme Court, for imparting legitimacy to the New Deal."⁴

Both recent evidence and past history

(Cont. on p. 8)

Briefs

□ The Pentagon has again raised its cost estimates on 37 of its 47 major weapons systems, thereby adding another \$4.3 billion to its budget. Just one project alone, the Army's Hellfire missile, increased 167% in cost over the last year, creating the necessity for a further \$80 million in outlays. The Patriot missile increased 53% in cost, adding \$285 million to the budget. Each of these cost increases is above and beyond those increases caused by the projected rate of inflation.

□ An internal memo being circulated at the Social Security Administration has admitted that the entire social security system could get bogged down in red tape during its attempt to implement President Reagan's planned cuts in benefits. Social Security Commissioner John A. Svahn said it will take the agency 9,000 worker-years and cost \$170 million to recompute the upcoming reduction in benefits. The memo pointed out that even under an optimistic scenario, "beneficiaries in large numbers across the nation will be faced with reductions or eliminations in benefits, overpayment notices, and poor service, not only on inquiries and postentitlement actions, but also initial claims. This will not be a one-month occurrence, but the reaction and the service deterioration will persist for at least one year."

□ The passage of "Proposition 2½" in Massachusetts has led to the layoff of thousands of state and municipal workers in the last few months. The proposition, overwhelmingly approved last November, cut the automobile excise tax in half and is forcing the state to lower property taxes till they reach 2½ percent of the property's fair market value. Some estimates indicate that 20,000 government employees will eventually be laid off because of these cuts.

□ A recent report from the University of Virginia notes that of the 44 states that have a personal income tax, 9 have already adopted some form of indexing for inflation, while another 6 are considering it. The 9 states with indexing are Arizona, California, Colorado, Iowa, Minnesota, Montana, Oregon, South Carolina, and Wisconsin. In most of these states indexing is used to adjust income brackets, personal exemptions, and maximum standard deductions.

□ Connecticut has become the first state to initiate a version of inner-city "enterprise zones," a concept designed to encourage economic growth and job creation in deteriorating urban areas by reducing taxes and regulation there. Any business either starting or expanding in a Connecticut enterprise zone will receive a 50% corporate tax credit and a seven-year freeze on property tax increases. Unfortunately, the legislature failed to include any deregulation initiatives, which are at least as important as tax incentives, and it perverted the concept by offering grants of \$1,000 for each new employee, thus offering yet another subsidy instead of just getting government out of the way.

□ Congressional auditors have found that senior bureaucrats are using bonuses intended to promote excellence to pad their own salaries and those of favored colleagues. A preliminary report by the General Accounting Office shows that officials are awarding the bonuses to themselves and their friends. For instance, of the five members of the Internal Revenue Service's Performance Review Board charged with selecting employees for awards, four received an award. "Even in the National Science Foundation, which prides itself on its objectivity and analytical methodology, 37% of the personnel within the director's office . . . received a bonus award, while only 16% of those involved in scientific research and technical fields received such bonuses," according to Rep. Edward Roybal (D-Calif.).

✓ Washington Update

- ✓ President Reagan has signed legislation authorizing an additional \$1.7 billion for the federal food-stamps program through 30 September in order to head off any immediate reduction in benefits. This emergency authorization measure pushes 1981 food-stamp spending up to \$11.5 billion. Although this money had already been appropriated by Congress, the effect of Reagan's action was to raise the legal limit on food-stamp spending in order to accommodate this increase.
- ✓ Sen. Russell B. Long (D-La.), senior Democrat on the Senate Finance Committee, has expressed tentative support for a proposal to use general revenues as well as the social security tax to finance Medicare in order to relieve the burden on the Social Security System. This proposal, which received its initial backing from labor unions, is intended as an alternative to President Reagan's benefit cuts. Long suggested that general revenues be used to make up half of the \$38 billion for the Medicare program in 1982.
- ✓ A researcher from the General Accounting Office testified in front of the House Surface Transportation subcommittee recently that it is unlikely that the federal government will have enough money to complete the interstate highway system or keep the highway trust fund solvent. It was noted that in order to complete the system under the proposed funding levels, the inflation rate could not exceed 5%. In order to save the highway trust fund it would be necessary to increase the current four-cents-a-gallon federal gasoline tax.
- ✓ The Justice Department has recently dismissed two antitrust suits brought against businesses by the Carter administration, the first time since 1976 any suit has been dismissed after it was filed. These dismissals are the first result of a major review by the Justice Department of at least six pending antitrust suits. The two cases struck down involved resale price maintenance in the trucking industry and an attempted merger of two brick producers.
- ✓ The Department of Agriculture has altered its food stamp eligibility regulations so that the income of illegal aliens may now be considered when determining a family's eligibility status. Under the previous rules, the income of illegal alien wage-earners did not count as part of a family's income, thereby enabling many families with illegal-alien relatives to qualify for food stamps. This change had been proposed by the USDA in 1977 but was not activated until a recent congressional mandate.
- ✓ The United States Export-Import Bank has extended \$85 million worth of credits to the Angolan government to finance an offshore-oil development. These credits provide for U.S. government loans to a development project being jointly run by Gulf Oil Corp. and Sonamgol, Angola's state-run oil company. The credits, which are being channeled through the Angolan central bank, will be used to fund a \$160 million project designed to raise the production of Angola's two largest offshore oil wells to 200,000 barrels a day.
- ✓ The Federal Home Loan Bank Board is in the process of proposing legislation that would continue the deregulation of the savings and loan industry. The legislation is expected to allow S&Ls to engage in more flexible lending practices, thereby further blurring the difference between banks and S&Ls. An S&L must currently have a certain percentage of its loans in mortgages and is generally prohibited from making certain kinds of short-term commercial loans, two restrictions that may be relaxed under the proposed legislation.
- ✓ The Federal Trade Commission has finished its hearings on national regulation of the funeral-home industry and has drawn up and approved a set of recommended rules. Many consumer groups had been

pushing for these rules since the early 1970s, but these efforts had been held up by disputes over how funeral homes should disclose prices to potential customers. The FTC resolved this dispute by striking down requests that funeral homes be forced to itemize their charges. These rules will be the first series of nationwide rules governing the funeral-home industry.

✓ The Reagan administration has backed down from its campaign pledge to repeal the 55-mph speed limit after encountering unexpected resistance from both congressional leaders and state legislatures. John McClaughry, a White House senior policy adviser, has said, "Our platform called for getting rid of 55, but we're not making any particular initiative to do away with it. It's a fight we don't need right now." As a result, the federal government will continue to enforce penalties against states who fail to enforce the law. Each year the federal government threatens to withhold road money from any state in which over half the highway traffic exceeds 55 mph.

✓ The Federal Communications Commission has ruled that cable systems may not transmit obscene or indecent programs if the programming is controlled directly by the operator. This decision was the result of a request for a ruling from the American Civil Liberties Union, which had argued for a legalization of such broadcasting. This decision affects only those cable stations run by the cable company itself.

✓ The Reagan administration has decided to remove a 100-year-old ban on the use of armed forces for enforcing civilian law by using the military as part of the federal government's drug enforcement efforts. Although soldiers and sailors would not have the power to make arrests, they would be used to help gather intelligence about ships or planes carrying drugs into the United States. A bill to this effect is expected to pass Congress with no difficulty.

The Supreme Court (Cont. from p. 7)

suggest that the Court has been more instrumental in accelerating the erosion of our economic liberties than in protecting them. When was the last time the Supreme Court ruled against an economic program or regulation *on principle*?

Just as the Supreme Court is supposed to furnish checks on the other branches of the federal government, these other branches are given checks on the power of the Supreme Court, perhaps the most important of these being the presidential power to appoint justices. Although President Reagan has recently been given an opportunity to exercise this power, there is no indication that his choice of Sandra Day O'Connor as a Supreme Court justice will reverse the current direction of the Court. While Reagan may be a strong advocate of the free market on a rhetorical level, his choice of Mrs. O'Connor is another indication that he is not prepared to back up this rhetoric with action. Although it is far too early to predict just what sort of justice Mrs. O'Connor will

be, early reports have characterized her as a nominee who "shuns ideological extremes." The *Washington Post* noted that "as a state senator, she sponsored and supported a wide variety of bills on social issues but followed no consistent ideological line."⁵ Lest anyone underestimate the importance of a single justice, the *Monthly Labor Review* has noted that the seven most important labor-management issues to come before the Court in 1979-80 were all decided by a single vote.⁶

If the appointment of better justices appears to be a vain hope, then what is the answer to our current malaise? It is probably unfair to place too much blame on our current set of justices, since it is really the institutional framework in which they operate that is at fault. Perhaps our original Constitution left open too many loopholes with both its "general welfare" clause and its giving Congress the right to regulate interstate commerce. Economist Walter Williams has suggested that we enact a new constitutional amendment,

one that would prohibit all government interference with voluntary exchanges between consenting adults. Even this should not be considered a perfect solution: John C. Calhoun has pointed out that "a written constitution certainly has many and considerable advantages, but it is a great mistake to suppose that the mere insertion of provisions to restrict and limit the powers of the government, without investing those for whose protection they are inserted with the means of enforcing their observance, will be sufficient to prevent the major and dominant party from abusing its powers."⁷

¹ *U.S. News & World Report*, 13 July 1981, p. 52.

² *Ibid.*

³ *The Record*, 3 July 1981, p. 10. (Emphasis added.)

⁴ Charles Black Jr., *The People and the Court* (New York: Macmillan, 1960), pp. 64-65.

⁵ *Washington Post*, 8 July 1981, p. 6.

⁶ *Monthly Labor Review*, April 1981, p. 13.

⁷ John C. Calhoun, *A Disquisition on Government* (New York: Liberal Arts Press, 1953), p. 25.

PR Reviews

Epistemological Problems of Economics, by Ludwig von Mises. New York University Press, 1981. \$7.00.

The Institute for Humane Studies Series in Economic Theory publishes new works and reprints classics within the tradition of the Austrian school of economics. This particular volume of methodological essays was originally published in German in 1933 under the title *Grundprobleme der Nationalökonomie*. At the time, Mises was one of the most well known members of the Austrian school of economics, but he was famous mainly for his contributions to monetary theory and the economic problems of socialism. This book marked his first major excursion into methodology.

It is often forgotten that both an economist's approach to analyzing economic problems and his policy conclusions are intimately related to his underlying epistemological and methodological suppositions. Failure to acknowledge this

connection has led to a separation of theory from practice and the use of innumerable economic concepts and methods whose underlying premises often go unchallenged. For instance, the predominant methodology in economics today is implicitly positivistic, emphasizing the "testability" of propositions. Both "cost-benefit" analyses, which attempt to measure the unmeasurable, and highly sophisticated (yet unreliable) econometric models are the outgrowth of such a methodology.

Mises's approach to economic science is diametrically opposed to positivism. Like Hayek's *The Counter-Revolution of Science*, Mises places his emphasis first and foremost on the methodological dualism of the natural sciences and social sciences. The methods appropriate to the former cannot be indiscriminately used by the latter. Instead, the social sciences should be distinguished by the subjective character of economic phenomena (e.g., tastes,

plans) and an emphasis on individual action. Since we have direct knowledge of what human beings are and how they act, we are able to formulate theories prior to the process of historical observation ("apriorism"). Felix Kaufmann has remarked, "I have nowhere found a more precise and impressive presentation of the aprioristic thesis than in L. von Mises' writings," a judgment with which this reviewer must concur. *Epistemological Problems of Economics* is highly recommended to all those interested in such methodological issues.

How the IRS Seizes Your Dollars and How to Fight Back, by George Hansen with Larrey Anderson. Fireside Books, 1981. \$6.95.

In this chilling exposé of the power of the federal government to confiscate citizens' incomes and infringe upon their civil liberties—all in the course of collecting tax revenues—Congressman George Hansen (R-Idaho) reminds us that "the

power to tax is the power to destroy," and illustrates this proposition by showing how the IRS can attach up to 100% of a debtor's property, seize property without a court order, force citizens to try their cases in IRS courts, and *legally* subject citizens to electronic surveillance. Hansen points out that "the violations of the rights of the American people today by their own government are ironically parallel to the injustices suffered by the colonists in the years preceding the Revolutionary War. The Declaration of Independence states that the British King "has erected a multitude of new offices, and sent hither swarms of officers to harass our people, and eat out their substance."

This book shows that the purpose of the

IRS is *growth*, and the different chapters illustrate the different techniques that the IRS uses to achieve this end. The title is misleading as it does *not* tell taxpayers how to fight back against such growth, but the book is nevertheless a useful examination of the operation of the IRS. The book is recommended to anyone interested in reading about one of our nation's largest and most powerful bureaucracies.

Protection or Free Trade by Henry George. Robert Schalkenbach Foundation, 1980. \$10.00.

In an age of mushrooming tariffs, quotas, and trade restrictions, Henry George's 1886 classic, *Protection or Free Trade*, is especially relevant. George's work, which is both clearly written and

tightly reasoned, may rightfully be considered one of the true classics of the free-trade literature of the nineteenth century, for George deftly discusses and disposes of all of the protectionist arguments against free trade. The infant industries argument, the balance of trade argument, and many others are all sharply refuted in this volume.

Unlike many other nineteenth-century liberals, George rests his argument on both utilitarian considerations *and* justice. His case is essentially based on the mutually beneficial and just nature of voluntary exchange. Not only is most of the economic and ethical reasoning sound, but George's argument goes far beyond economics to show a fine appreciation for the historical relationship between protectionism and war and tyranny. In one instance he notes that "there is something in the word 'protection' that ought to make working-men cautious of accepting anything presented to them under it. The protection of the masses has in all times been the pretence of tyranny."

Unfortunately, Henry George is too often remembered for his advocacy of the single land tax, while many of his other contributions go unnoticed. Although the last eight chapters in this book are seriously marred by an extensive concern with the land issue, the first twenty-one chapters are solely devoted to free trade.

Protection or Free Trade is highly recommended as both relevant and readable. The Robert Schalkenbach Foundation is to be commended for reprinting such a classic.

A Property System Approach to the Electromagnetic Spectrum: A Legal-Economic-Engineering Study by Arthur S. DeVany, Ross D. Eckert, Charles J. Meyers, Donald J. O'Hara, and Richard C. Scott. Cato Institute, 1980. \$4.00

The federal government has been interested in the electromagnetic spectrum since the 1920s, the early days of broadcasting. With the Federal Radio Act of 1927 and the Federal Communications Act of 1934, Congress established methods for allocating uses of the spectrum that have continued to exist down to the

Regulatory Watch

CIVIL AERONAUTICS BOARD

The Civil Aeronautics Board has proposed rules that would eliminate the current ability of foreign air carriers to carry travel agents or travel promoters and their families at no charge or reduced fare. This practice was originally legalized for both foreign and domestic travel agents on the grounds that it "was in the industry's economic interest to have travel agents and other transportation related professionals take trips that would put them in a better position to sell the product." The revocation of this ruling for foreign air carriers is due largely to the failure of many foreign governments to extend similar privileges to U.S. air carriers. The new regulations would allow the CAB to retaliate against such practices by eliminating the freedom of foreign air carriers to offer free or reduced fares to travel agents, without granting the foreign carrier a hearing.

Recent computations by the CAB have established the new "standard industry fare level" (SIFL), which is required to be updated at least twice a year by the Airline Deregulation Act of 1978. The original SIFL was based upon 1 July 1977 fares and is adjusted by a complicated procedure that increases or decreases it, depending on the percentage change in operating costs per available seat-mile. Once computed, the SIFL is used to establish a bench mark for measuring the propriety of fares according to what is known as the "statutory zone of reasonableness."

A January 1980 CAB proposal regarding restrictions on permissible cargo rates in international air transportation has recently been reissued for additional comments. The new rules would establish standard cargo rate levels based on cost considerations for each market. Proposed rate changes would now be allowed to escape review as long as they were within a 5% margin of the CAB level. These regulations, which had previously been dormant, were reopened for comment after a petition from Electronic Shippers, Inc.

The CAB has relaxed the requirements that forced airline carriers to submit data on service operations to the board before releasing it to the public. Previously, carriers had to wait until all other carriers had submitted similar information to the CAB and until the CAB processed the information. The new rule eliminates all restrictions on the release of much of this service data.

New methods are currently being developed by the CAB to inform airline passengers of the contractual terms under which they travel. Under the current system the airline draws up a long, technical list of all the relevant contractual information regarding its services and submits this list (called a "tariff") to the CAB. Airline passengers are then bound by these terms whether they know them or not. One CAB suggestion would force an airline to summarize its "tariff" in a document written in plain English and distribute such a document to its customers.

One of Hayek's most important conclusions is that these misapplications of the scientific method have laid the groundwork for the modern totalitarian state. Friedrich A. Hayek is one of the most important thinkers of the twentieth century, and *The Counter-Revolution of Science*, originally printed in 1952, is one of his most important works, a very complex and highly recommended book. ■

ifies the three most dangerous fallacies of scientism as objectivism, collectivism, and historicism, and subjects each one to a searching critique. Human beings, the subject of the social sciences, simply cannot be manipulated the way that unthinking atoms, the subject of the natural sciences, can be. The philosophy underlying this attempt to manipulate individuals is traced back to Saint-Simon and Comte.

present day; the Federal Communications Commission was created and given the power to divide up the spectrum and issue broadcasting licenses.

The FCC and its work come under strong criticism from the authors of this paper because "First, the rights granted to licensees have been so inflexible that there are few incentives for them to make economically efficient use of communications resources—transmitters, receivers, and the radio spectrum itself. Second, the regulatory procedures established over forty years ago have not been adapted to the dramatic changes in technology and demand that have occurred since the end of World War II." Building on the work of Coase and Demsetz, the authors outline a method of allocating the spectrum on market principles and show how a transition to such a system could be made under present conditions. What makes the argument particularly impressive is the detail in which the authors, whose legal and engineering credentials are unchallengeable, present their reform proposal.

While not suitable for casual reading, *A Property System Approach to the Electromagnetic Spectrum* is an extremely important addition to the current public policy debate over the FCC and deserves a wide audience among all those interested in the problem.

The Counter-Revolution of Science: Studies on the Abuse of Reason by Friedrich A. Hayek. Liberty Press, 1979. \$9.00 (cloth), \$4.00 (paper).

Nobel laureate Friedrich A. Hayek's *The Counter-Revolution of Science* is both one of the classic statements of the Austrian or "subjectivist" approach to the social sciences and a devastating critique of the philosophy of "scientism" that underlies modern attempts at social engineering. Although highly technical in its approach, Hayek's book is an indispensable guide to the problems that have pervaded philosophy, economics, and political science in the twentieth century.

Scientism, broadly defined, is the belief that the methods of the natural sciences (such as physics) may be indiscriminately applied to the social sciences. Hayek iden-

GOVERNMENT SPENDING MONITOR

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

EXPENDITURES (annual rate in billions of \$)

	1981 Second Quarter	1981 First Quarter	1980 Fourth Quarter	Average for Last 4 Quarters
Federal Government	669.7	668.8	642.4	651.9
Defense	159.9	176.0	149.2	140.4
Labor	28.2	34.4	31.2	33.2
Education	14.9	17.2	14.4	14.9
Health and Human Services	229.2	226.0	220.4	221.6
HUD	16.8	13.6	14.4	13.7
Energy	14.5	9.6	9.6	10.5
Transportation	18.3	26.4	22.0	21.9
Federal Aid to State and Local Gov'ts	88.7	90.2	88.9	88.9
Federal Interest Paid	107.0	81.3	86.0	85.4
Federal Transfer Payments	275.2	271.9	268.1	270.0
Federal Surplus or Deficit	16.2	-128.4	-134.0	-93.9
Reported Federal Debt	974.8	964.6	917.4	937.8
Total Government Employment, All Levels (millions)	16.0	16.2	16.0	16.1

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

"To be governed..."

The tax rate is higher on investments

A federal judge in Maryland imposed a two-month prison sentence on Mary F. McCotter, of Landover, who pleaded guilty to filing 299 false expense vouchers in her job at the National Weather Service. The Commerce Department said the false vouchers totaled more than \$29,000. McCotter was ordered to pay back \$15,000.

—*Washington Post*, July 8, 1981

You say you're a taxpayer, sir?

Do you have an invitation?

Chrysler Corp. probably didn't generate a lot of black ink in the second quarter, but it was apparently enough to warrant sharing with some friends.

As part of the buildup to today's expected announcement of Chrysler's first quarterly profit in two years, chairman Lee A. Iacocca was scheduled last night to pass out little tokens of appreciation to those Senators and Representatives who supported a \$1.5 billion federal rescue bill for the company in Congress 18 months ago. Guests invited to a "low-key, stand-up" reception in the Capitol were slated to receive small bottles of black artists' ink. Affixed to the 275 or so bottles are stickers reading: "Black ink now in use at Chrysler Corp. thanks to your help."

—*Wall Street Journal*, July 22, 1981

Couldn't happen to a nicer guy

Losing the public's good will can be fatal. Barry Warfel lost his small business

because of a public relations blunder. . . . 11-year-old Billy Halliwell showed up outside (Warfel's coffee shop) peddling coffee and snacks from a red wagon (during the 1979 gas lines) . . . Then the local health inspector, a friend of Mr. Warfel's, told Billy he couldn't sell food without a license.

Mr. Warfel was caught in a nightmare of negative publicity. . . . People shunned his coffee shop, sales plunged. . . . He sold his shop.

—*Wall Street Journal*, June 15, 1981

A lasting monument to government

Columbia, S.C.—The folks here were mighty proud when the federal government decided to build a 15-story tower in a fading section of downtown Columbia, a modern architectural work that would serve as a lasting monument to South Carolina's senior senator.

But since last spring, when the building finally opened—more than two years behind schedule—the Strom Thurmond Federal Building has come to symbolize everything that can go wrong with a government project.

It has been plagued by huge cost overruns and a flurry of legal claims by contractors that total more than \$8 million.

It has been infested by rats and flooded by the city's water system.

It has a row of 30 sparkling white steps on the left side of the building leading directly into a concrete wall.

It has no place to park, because plans

for a parking garage were scrapped after a construction firm began to build it.

It has courtrooms that are too dark, too noisy and too small to handle a trial with several defendants.

—*Washington Star*, June 16, 1981

And then the First Amendment?

The Supreme Court, limiting the discretion of broadcasters, said candidates for federal office have a legal right to buy air time on television and radio during campaigns.

The decision also upheld Federal Communications Commission authority to determine when a campaign has begun. . . .

Andrew Schwartzman, director of the public interest law firm, Media Access Project, said the opinion was "an overdue reminder that services come first and ratings come second."

—*Wall Street Journal*, July 2, 1981

If at first you don't succeed

The consensus economic forecast now favors zero growth in the second quarter, followed by a slight pickup in the third, and 3% to 4% gains this fall and next year. But Robert L. Marks of Siff, Oakley & Marks, Inc., economic consultants, points out that since early 1980, the consensus view has been wrong on the direction of change in four out of five quarters and has also missed the magnitude of change by an average of seven percentage points.

—*Business Week*, July 27, 1981

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