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America's Rendezvous With Reality

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America's Rendezvous with Reality

by Murray Weidenbaum

*Contemporary
Issues Series 30*



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America's Rendezvous with Reality

by Murray Weidenbaum

I am pleased to have the opportunity today to provide you with a sneak preview of my new book, *Rendezvous With Reality: The American Economy After Reagan*. It is designed to be a personal look at the problems and potentials of the United States in the decade ahead.

More specifically -- as the title suggests -- I have attempted to find solutions to the economic policy problems that will face our next president, be he Democrat or Republican. In doing so, I part company with both of the party conventions we've watched and listened to recently. I do not think that the Reagan period has been either the unalloyed blessing we heard about during the Republican Convention or the dismal failure we heard about at the Democratic one. I think it has been a mixed bag.

The Reagan era produced some tremendous triumphs -- bringing inflation down, lowering interest rates, sustaining economic growth -- and achievements in areas no one has talked about, like the unprecedented degree of labor peace. It is interesting to note that when you go overseas -- I spent some time in Germany this summer -- you hear people referring to the "American job miracle." The Europeans envy our job creation ability. But when you get back home, you find people taking all that for granted.

On the other hand, the budget deficit has

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tripled, the national debt has more than doubled, and the federal government is a larger presence in the economy today than it was in 1981. That has to be on the negative side of the ledger.

As a nation -- and not only since 1980 -- we Americans have been avoiding some of our toughest choices. Over the last several decades, we have been consuming more than we are spending, borrowing more than we are saving, and spending more than we are earning. While advocating balanced budgets, we have voted for rapid expansions in expensive government activities, ranging from defense to farm subsidies. The next presidential administration will have to take on a role akin to that of a cleanup crew the morning after a big party. And that brings me to the most important theme of my book. The major challenges that will face the next administration, Democratic or Republican, can no longer be ducked, they must be squarely faced.

A Few Examples of Needed Reform

Reforming Welfare

Among the challenges that I deal with in *Rendezvous with Reality* is welfare -- how to reduce poverty. As it turns out, there is a growing consensus on the part of people who have really analyzed the problem. The solution to poverty, when you get down to it, is simple. Notice that I did not say the remedy is easy, but it is simple. Take a person who graduates from high school, gets married and gets a job -- any job, even a minimum wage job. The odds are that he or she will never experience poverty. Those three factors are interrelated.

If you graduate from high school, you are more likely to get a job. With a job, you can afford to get married. Being married, you're more inclined to keep the job. You are not likely to blow your stack and quit the first time you get reprimanded by the boss.

Reforming Military Procurement

The recent "scandals" involving military procurement suggest the need for reform. My view is a bit different because I have actually examined some of the facts about defense production and have found it to be the most highly regulated industry in the country. The solution we keep hearing -- to regulate defense contractors more closely -- will not help at all. Frankly, that approach reminds me of the old hangover cure, "having a bit of the hair of the dog that bit you."

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In order to improve the efficiency of weapon systems production we need to deregulate and privatize. Compare the sheer multitude of paperwork -- the tons of paperwork -- that must accompany a company's proposal for a single aircraft or missile system, with the pounds of paperwork for a commercial airliner of comparable size. It would save tremendous amounts of taxpayer dollars to reduce the paperwork. More important, some deregulation would free up scientists and engineers for the serious work of designing and building better equipment for the defense establishment.

Unfortunately, I think true defense procurement reform is an uphill battle. The trend seems to be toward more detailed and onerous regulation. Yet, I'm an optimist. Perhaps as more people read and learn about the real nature of regulation of defense production, they will see the light.

I also try to deal with a variety of other areas of public policy in the book. For example, in the face of much gloom-and-doom talk, I show the increasingly obvious *strength* of the manufacturing sector. Inevitably, I've got a couple of chapters on needed reforms

of regulation, including a whole chapter on environmental regulation.

A Policy Menu for the Next President

Finally, I present what I call a "menu" for the next administration, focusing on what I believe will be the key policy problems. We don't need a "laundry list"; we need to think in terms of priorities. And the key need of the American economy is to improve productivity and enhance competitiveness.

Improving Productivity

I'm sure that whether George Bush or Michael Dukakis wins the election, the next President will want to enhance the competitiveness of the American economy. But how do you do that? It requires a combination of positive and negative actions.

The positive approach turns out to be -- and there's a growing consensus on this -- to improve the education of the American work force. It is a national disgrace that our literacy rate is lower than the Asian rim countries'. Our dropout rates are also higher than in the Asian countries. It also hurts when Japanese companies take over American firms and tell us that they need to hire college graduates here to do the kind of mathematics that their high school graduates are trained for.

It is not a question of spending more money on education. If you look at the numbers, we have been spending money on education at a rising rate all through the past decade.

Let me give just one example, however, of how this money has been misappropriated. New York City recently allocated funds for an adult education program. Sounds good. But, as it turned out, most of the money went to overtime pay for custodians. Now, paying janitors an adequate wage is useful; and maybe it is better to give the extra money to the janitors than to give it to a new assistant

superintendent of schools. But it would be better yet to give it to teachers.

There are also actions that we should refrain from taking. I note the rapid growth in the number of proposals that mandate social benefits. Requiring companies to provide more generous fringe benefits -- for health insurance, personal leave and higher minimum wages -- is popular with Congress because it does not cost the Treasury anything.

But each of those actions increases the cost of producing in the United States. That doesn't help productivity a bit. It hurts our national competitiveness. But few people have yet made the connection. It is ironic that the same people who make all sorts of speeches about the need to enhance our competitiveness support legislation to erode the productivity of American business by imposing yet another costly social mandate.

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The third aspect of enhancing competitiveness and productivity is to learn from the mistakes of *both* recent administrations in the area of government regulation of business. President Carter appointed a slew of anti-business regulators who used EPA, OSHA, and the other agencies to punish business. And the Reagan administration, embracing "regulatory relief," ran into serious difficulty because it was looked upon as only trying to lighten the load on business.

What we really need is a round of regulatory reform aimed at the most cost-effective way of carrying out the responsibilities of EPA, OSHA, etc. The current logjam in dealing with hazardous wastes and air and

water pollution can be broken by some policy innovation. Let us use economic incentives. Effluent charges and disposal fees work well in Western Europe, where scientists and engineers (rather than lawyers) dominate environmental regulation.

Reducing the Budget Deficit

I do not believe we can avoid talking about the budget. I'm old-fashioned enough to worry a great deal about triple digit (in billions of dollars) deficits. Let's face it, a lot of my conservative friends don't like to talk about budget deficits any more. But if Jimmy Carter had experienced these budget deficits, he would have been run out of town on the proverbial rail.

Deficit financing today is going toward current consumption which will not generate the return on investment necessary to service the national debt.

But what really worries me is not so much the size of the deficits but what the debt has been used for. I'm one of the many of my generation who went to college, at least in part, under the GI bill. That was a definite federal *investment* in education. The VA has shown that the taxes paid on the additional income resulting from the increased level of education more than repaid the government's initial outlay. The GI bill was a good use of government funds.

What is the increased debt financing now? Not investments such as education or research and development or airports and other infrastructure. It's going for current consumption: entitlements, farm subsidies, interest and defense spending -- none of which will generate the return on investment to service the debt, much less repay it.

Whether you are a Democrat, Republican

or Independent, if you go through the federal budget, department by department and agency by agency, as I did in writing *Rendezvous with Reality*, you will find weak spots in every part of the budget -- with no exceptions. When I hear talk about increases in taxes, the economist in me is offended. It is a confession of the unwillingness to make tough budget choices.

Of course, it's not easy to say no to an organized pressure group, but this is one of the lessons of 1981. Don't just hit one pressure group, but take them all on. To prime the pump, this old budget cutter has developed his favorite "dirty dozen" federal spending programs which have outlived their usefulness or are simply unfair burdens on the average taxpayer. Table 1 outlines how \$100 billion could be saved in fiscal year 1992.

The selection is based on the old budget motto, "Good budgeting is the uniform distribution of dissatisfaction." In that spirit, substantial cuts or total eliminations are proposed for sacred cows traditionally supported by military proponents and welfare recipients, farmers and senior citizens, Zionists and Arabs. If any powerful interest group has been omitted, that is purely unintentional.

After displaying the intestinal fortitude to send these budget cuts to the Congress, the President should take a second step -- present a package of needed reforms for government decisionmaking. A good start would be to extend budget cutting to Congress and its staffs, which have been growing so much faster than the executive branch of the government. Cut back sharply the excessive number of subcommittees. Back in the 1930s, Louisiana Senator Huey Long proclaimed, "Every man a king." Today's version is that every member of Congress is royalty, judged by spending for their entourage. And almost every member of the majority party has his or her own subcommittee to chair -- with the requisite perks and pork.

Table 1

**Budget Savings from
Weidenbaum's Dirty Dozen**
Fiscal Year 1992
(\$ in billions)

1. Eliminate farm subsidies	\$25
2. Adopt military procurement reforms (save 10% of \$155 billion spent a year)	15
3. Adopt a "diet COLA" for social security (limit COLA to rise in CPI above 2%)	15
4. Adopt a "diet COLA" for other entitlements	12
5. Postpone military retirement to age 55	10
6. Repeal Davis-Bacon Act on construction wages	9
7. Cash out food stamps (save 40%)	5
8. Close unneeded military bases	2
9. Raise interest rates on federal credit (reduce demand by one-fourth)	2
10. Eliminate VA hospital stays for non-service illnesses	2
11. Reduce foreign aid to the Middle East	2
12. Stop pork barrel projects of the Corps of Engineers and the Bureau of Reclamation	1
TOTAL	\$100

Conclusion

In summary, the legacy of Reaganomics is a mixed bag containing lower inflation and higher budget deficits, lower unemployment and higher trade deficits, fewer strikes and more government jobs, the deepest recession in a half century and the longest peacetime recovery ever.

In any event, Reaganomics is a closed chapter in American economic history. The tax debate has shifted from cutting rates to increasing revenues. Rapid increases in the defense budget have been supplanted by attempts to curtail it. And "regulatory relief" is no longer an active term in the policymaker's vocabulary.

The two items proposed here -- productivity enhancement and budget restraint -- are far more modest than the typical presidential laundry list of the past. That does not reflect a lack of imagination but a determination to learn from the overpromising of previous administrations.

No president or Congress can repeal the concept of compound interest. The longer we as a nation wait to make the tough decisions outlined in this talk -- to improve our personal efficiency and to reduce our national indebtedness -- the more difficult will be the task of tackling them. Americans today truly face a rendezvous with reality.

Question and Answer Session

Question: We're reading so much about the impending surpluses in the social security trust fund. Does this mean that the problem of deficits is going to vanish?

Answer: I take those numbers about social security surpluses with more than a grain of salt.

First of all, look at the economic assumptions. One of these assumptions is that there will be no recession between now and the year 2015. I'm not sure when the next recession will be; but I am virtually certain that the United States will experience several recessions between now and the year 2015.

I am very suspicious of many other assumptions -- governing inflation, wage rates, etc. And there's a key point the forecasters have missed that reduces the size of those projected surpluses immensely. In estimating budget deficits you must "consolidate" the trust funds and the rest of the budget. Over 40 percent of those prospective surpluses results from the interest paid by the Treasury to trust funds. Those "interfund transfers" do not reduce the deficit a nickel. Every dollar that the trust fund collects in interest from the Treasury, the Treasury is paying out. It's a "wash transaction."

There is a more basic point that people forget about when talking about the social security surpluses. Perhaps we're generating surpluses because we're trying to finance a system that basically is out of whack, whose benefits are too generous in relation to the contributions paid in by future retirees. The average senior citizen now has become more wealthy than the average working person.

Most of the typical monthly social security check is not a return of the employee contribution (plus employer contribution and interest), but a gift from the working population. Because "junior citizen" workers are required to pay the money used for social

security benefits to "senior citizens," they should be entitled to question generous annual increases in social security checks. Few working people get the full cost of living adjustment (COLA) that every social security recipient now receives.

If the American Association of Retired Persons could look at social security as part of the total federal budget problem, perhaps it would pull in its horns. We could ask our well-off or comfortable senior citizens to contribute to improving the situation for their children and grandchildren by going along with the budget cuts being asked of every other citizen in this society.

Question: You might fill our guests in on what you'll be doing on your nine-month sabbatical. (Kenneth Chilton, Associate Director.)

Answer: I will be at the Center for Strategic and International Studies in Washington, D.C. They published some of my earlier work on the economic impact of the Vietnam War and on the economics of defense. I thought that the sabbatical was a nice time to shift gears and do something different for a while.

I'm going to do a number of things. My first assignment is to get involved in planning, on a nonpartisan basis, the transition for the next presidency. A group of us -- who have been involved in presidential transitions in both parties -- are examining what lessons we can learn from the past. Are there specific suggestions that we can make in terms of procedure (not in terms of policy) and organization for the next presidential administration? That's a short-term project.

My longer-term project is a response to a book that has been on the best seller list for a long time, Paul Kennedy's *Rise and Fall of the Great Powers*. It is an interesting book and is very impressive in its coverage of European history in the 15th, 16th, and 17th centuries.

The last few chapters -- which is the part that has received the most public attention -- deal with Kennedy's contention that our "over-extended" military commitments and tremendous military burden are dragging the United States down. According to Professor Kennedy, this is why our country is declining in the global economy.

Well, you back into these things. I write a monthly column for the *Christian Science Monitor*, and I devoted one recent column to a rebuttal of Kennedy's thesis. I also chided him for a lack of historical perspective -- which I gather from his letter to the editor did upset the distinguished historian. But his book does lack historical perspective, because the analysis of U.S. defense relies almost entirely on cross-sectional data, focusing on the Reagan period.

In contrast, I showed that, over the past half century, the burden of the military on the U.S. has been going down. This is true any way you measure it -- percentage of GNP, or the share of R & D going to the military, or the federal budget, or the labor force. So the idea that a rise in military commitment is dragging the United States down flies in the face of the facts.

Of course, if you look at the past half century, you'll see a little tremor during the early 1980s, but that kind of temporary blip is hardly damaging American national or economic security. I intend to take some time to analyze the implications more deeply.

I also know what I *don't* intend doing during my sabbatical. For the first time in a long time I've been able to stick with saying "no" to various overtures from political campaigns. I've served my penance, and it's someone else's turn. There is no shortage of good people who want to and should get involved.