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9-1-1984

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Recommended Citation

Weidenbaum, Murray L., "An Economist's Look at the 1984 Elections--and Beyond", Occasional Paper 35, 1984, doi:10.7936/K70V8B01.

Murray Weidenbaum Publications, https://openscholarship.wustl.edu/mlw_papers/90.

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AN ECONOMIST'S LOOK AT THE 1984 ELECTIONS -- AND BEYOND

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HIGHLIGHTS

Economic Issues Beyond the Deficit

"One unfortunate side effect of the debate on the deficit is that it overshadows many other important economic issues." For example:

Antitrust Laws -- "Firms that are statistically labeled 'oligopolists' because they still dominate domestic sales of a given product are increasingly faced with tough competition by foreign firms of similar size A change in Administration can be expected to make large mergers more difficult and fewer likely to happen."

Labor-Management Relations -- "It seems clear that labor costs would rise faster in a Mondale Administration. . . . That change also would reflect the greater social concern over unemployment than the economic concern over inflation."

Foreign Trade -- "It is hard to meet a self-confessed protectionist in either party The sad truth of the matter is that both parties have moved toward protectionism, but with different degrees of rapidity."

Regulation of Business -- "The backlash from actions taken by the original appointees at the Department of the Interior and the Environmental Protection Agency has moved the reform of environmental regulation to the back burner."

The Deficits

"The Democrats are now making louder noises than the Republicans about the need to curb the deficit, especially via tax increases."

Expenditure Priorities -- "President Reagan consistently supports large increases in defense spending and is sympathetic to cuts in civilian programs. . . . Mondale proposes to reverse that set of priorities."

Tax Policy -- "The ability of either party to cut tax rates depends on the willingness to control the growth of government spending. The likelihood of that occurring to any substantial degree remains slim."

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by Murray L. Weidenbaum

As the political season heats up, it gets increasingly difficult to separate analysis from advocacy. As a former member of the Reagan Administration, I am mindful of the fact that my ability to be objective is somewhat short of total. Nevertheless, as a professor of economics, I would like to try to distinguish the likely economic differences between a second Reagan term and a new Mondale Administration, especially as they affect the business community.

The General Economic Outlook

At the outset, let us note some changes in the economic environment that will probably occur regardless of the results of the event taking place on the Tuesday following the first Monday in November of 1984. Specifically, it looks like 1984 will be a peak year for the performance of the American economy. Most forecasters are predicting for 1985 a combination of less growth and more inflation than in 1984, but still a respectable year compared to the combination of a recession or slow growth and inflation that characterized the recent past. On a monthly basis, many companies and individual industries are already experiencing that change.

A word of caution. Should 1985 unfold as I have just indicated, that would not prevent Democrats from saying, "I told you so," should Ronald Reagan

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be reelected. Of course, Republicans would draw the obvious and reverse inferences in the event that Mr. Mondale is in the Oval Office when the economy weakens. Either political conclusion would lack a serious economic foundation. Nevertheless, the differences between the two candidates in this area are extensive. Let us explore them.

Basic Themes

At the broadest level, there are key differences in emphasis and in the basic economic themes that will be developed by the Presidential Administration taking office in January 1985. Although there is always a danger of oversimplification, I expect a Mondale Administration to give more attention to unemployment, while a second Reagan Administration might focus more on keeping inflation down. In a sense, this reflects each of the candidate's fundamental viewpoint -- one stressing concerns that are basically economic, while the other concentrates more on social policy matters.

Similarly, the Republicans tend to give more weight to private initiative and the Democrats to increasing involvement by government. All this is reflected in positions on specific issues. Thus, in dealing with the deficit issue, Democrats favor income tax increases, especially in the higher brackets, and Republicans prefer cuts in civilian spending, mainly for the social programs.

Economic Issues Beyond the Deficit

Enforcement of the Antitrust Laws

One unfortunate side effect of the debate on the deficit is that it overshadows many other important economic issues. For example, it is likely that the current favorable attitude on the part of the antitrust agencies toward mergers between large companies would change in a Mondale

Administration. "Trust busting" would become fashionable again, although perhaps not to the extent of the past.

I say this because it is becoming clear that many U.S. companies must compete in a global market. Thus, firms that are statistically labeled "oligopolists" because they still dominate domestic sales of a given product are increasingly faced with tough competition by foreign firms of similar size. The world market shares of major American companies are often modest when considered in the light of the historical concerns of antitrust law enforcement to reduce the "concentration" of industry. Nevertheless, a change in Administration can be expected to make large mergers more difficult and fewer likely to happen.

A related legal matter is the changing composition of the Supreme Court. With many of the Justices in their late seventies, a major round of appointments is likely within the next four years. Thus, the next president will have the opportunity to influence the direction of the court for a long time to come. It is likely that Mondale appointments would reflect his general position on antitrust issues, as well as other economic and legal matters.

Labor-Management Relations

Similarly, the tone of labor-management relations likely would change. On balance, the power of organized labor would increase in a Mondale Administration. This development would be more than just a reflection of the strong support that Mondale has received from the AFL-CIO. Hindsight tells us that President Reagan's tough response to the illegal PATCO strike created a new atmosphere in labor-management relations, an atmosphere that a Democratic Administration will feel obliged to change.

By the way, this is a good example of the emphasis of this report -- to identify differences rather than to pass judgment. Thus, some people view the current union environment in the United States more favorably than the situation that existed until 1981. In contrast, others believe that the last four years constituted a period of reversals, especially for organized labor.

Also, the Democratic platform, but not that of the Republicans, contains the notion of "comparable worth." This controversial approach to setting pay scales is based on the belief that wage differentials between male-dominated and female-dominated occupations mainly reflect an inherent bias against women. "Why should school teachers get paid less than auto mechanics?"

Under this doctrine, employers would be prohibited from paying less for jobs in female-dominated positions requiring an equivalent amount of "skill, effort, and responsibility" than for comparable male-dominated positions. "Comparable worth" would replace market forces in setting pay scales with governmental and bureaucratic decision making.

Surely, it seems clear that labor costs would rise faster in a Mondale Administration because of the more favorable attitude toward unions. That change also would reflect the greater social concern over unemployment than the economic concern over inflation. A related issue is protectionism -- the restrictions on imports into the United States which enable domestic costs of production (including labor costs) to rise above competitive world market levels.

Protectionism

Protectionism is a good example of an economic issue where it is difficult to distinguish between the two parties. We need to push rhetoric

aside because it is hard to meet a self-confessed protectionist in either party. The typical response is, "I'm all for free trade -- but. . . ." The sad truth of the matter is that both parties have moved toward protectionism, but with different degrees of rapidity. The Carter Administration negotiated a variety of "orderly marketing agreements," covering such items as textiles and shoes, whereby other nations agreed to limit their exports to the United States. The Reagan Administration has taken specific actions to restrict imports of automobiles, motorcycles, steel, sugar, and textiles. In some cases, notably motor vehicles, the Administration's action was justified by the desire to head off more severe legislation. However, the Reagan Administration did reject some pleas for protectionism, notably from copper and shoe producers.

All, in all, there is an important difference in each candidate's general attitude toward trade restrictions. The proposed "domestic content" bill -- which would, in effect, permanently keep out cars produced by the larger Japanese companies -- is a useful sorting device in this regard. The Administration is against it; former Vice President Mondale, along with the United Auto Workers Union, is for it.

It is interesting to note that restricting imports hurts domestic consumers, who bear the burden in terms of the higher prices that result. Neither party can accurately say that it represents the consumer on this issue. However, the Republicans may have a marginally stronger case for making the claim than the Democrats.

Regulation of Business

On the surface, it would seem clear that a Republican Administration would advocate less regulation of business and a Democratic Administration

would favor expansion of government intervention into private economic decision making. Yet the reality is far more complicated.

Both the Ford and Carter Administrations actively promoted economic deregulation, notably of transportation. An observable slowdown in this area has occurred during the Reagan Administration. However, candidate Mondale has stated that the country needs to digest recent economic deregulation before embarking on any additional moves in this area.

In the social regulation field, however, the differences are more apparent. Since January 1981, OSHA -- everyone's favorite whipping boy -- is no longer a four-letter word. On the other hand, the backlash from actions taken by the original appointees at the Department of the Interior and the Environmental Protection Agency has moved the reform of social regulation to the back burner. Nevertheless, the fundamental party differences seem clear: The Republicans under Ronald Reagan tend to oppose large and rapid expansions of social regulation while Democrats almost invariably welcome the opportunity to endorse further programs of governmental rulemaking.

Ironically, the Democrats under President Carter seemed more willing to engage in experiments to introduce economic rationality into the environmental regulatory process than has been the case thus far during the Reagan Administration. With the appointment of William Ruckelshaus to head the EPA, that situation has changed somewhat. Nevertheless, a cynic might conclude that the Democrats favor enhancing the efficiency of environmental regulation in order to maintain public support for this activity. In contrast, Republicans are less likely to reform the existing regulatory approach because they are not overly concerned about erosions of public confidence in the regulatory process.

Industrial Policy

Another area of disagreement between President Reagan and former Vice President Mondale is industrial policy. Mondale, as well as many other Democrats, supports the notion that the Federal government should intervene more directly in decisions concerning which enterprises and products should be financed. While the Congress -- including Republicans as well as Democrats -- has enacted laws to bail out specific companies such as Chrysler and Lockheed, the two parties tend to view such actions very differently.

To most Republicans, these actions were exceptions to a free-market philosophy agreed to with much reluctance. To a rising number of Democrats, such ad hoc decision making is unfair and inefficient; they believe it should be replaced by a comprehensive Federal effort to promote the development of specific sectors of American industry, e.g., an industrial policy.

I have emphasized these microeconomic issues because, with all the attention lavished on macroeconomic matters, they have been ignored. Let us now turn to governmental policy in the area of macroeconomics.

Macroeconomic Issues

Talking about different ways of grappling with those \$200 billion deficits reflects the different economic philosophies of the two presidential candidates. How to reduce the huge and unprecedented gap between the government's income and outlays is no trivial question.

It is far more important than U.S. policy on Quemoy and Matsu, the now-forgotten disputation by candidates Nixon and Kennedy in 1960. At that time, their stands on these two small islands, located between the island of Formosa and mainland China, were considered to be an important indicator of presidential potential. Currently, dealing with the deficits may not be as

vital as the volume of rhetoric would indicate. Nevertheless, reducing the government's financing gap does involve choosing among expenditure priorities and various forms of tax changes. It also introduces the key question of monetary policy and the role of the Federal Reserve System.

Those Deficits

Both parties and both candidates are, of course, strongly opposed to large budget deficits. Still, it appears that being out of office seems to whet the appetite for deficit trimming while actually holding office tends to dampen the ardor. In any event, the Democrats are now making louder noises than the Republicans about the need to curb the deficit, especially via tax increases.

Meanwhile, Republicans, at least many of them, are relying more heavily on economic growth to reduce the Treasury's borrowing. Yet, if history is an adequate guide, the Democrats -- rather than the Republicans -- would be more likely to advocate policies to pump up the economy. A Democratic Administration would urge the Federal Reserve to set higher targets for money supply growth in order to expand the income base on which the major Federal taxes are levied (and also reducing the demand for cyclically-sensitive programs such as unemployment compensation).

Republicans, at least in the past, have been more concerned with minimizing inflationary pressures. This desire is usually translated into advocating slower rates of monetary growth. In the short run, such action reduces the base on which income taxes are levied and thus increases the deficit.

Expenditure Priorities

The differences between Reagan and Mondale on specific expenditure priorities seem quite clear. President Reagan consistently supports large increases in defense spending and is sympathetic to cuts in civilian programs, especially means-tested social benefits. Mondale proposes to reverse that set of priorities.

Within the overall category of civilian government spending, the Reagan Administration has favored the programs of the Departments of Agriculture, Commerce, Interior, Justice, and Transportation. The Democratic approach supports significant increases in the Departments of Education, Health and Human Services, Housing and Urban Development, and Labor.

In a sense, it is a choice between producer-oriented functions and social welfare activities or, stated more broadly, between growth (investment) or equity (current consumption). In terms of economic categories, the key decision is in terms of purchases from the private sector (defense, agriculture, etc.) or transfer payments to individuals (welfare, health payments, etc.).

Tax Policy

Candidate Mondale has proposed to raise income taxes, particularly on the higher brackets, and to postpone or eliminate indexing of the personal income tax. In contrast, Reagan has vowed not to raise income tax rates. That allows, of course, for the introduction of a value-added tax (VAT), or expenditure tax, or some other consumption-type tax. Each of these alternatives exempts saving -- and thus promotes investment. However, opposition to any new tax is likely to unite many liberals and conservatives, although their motives will differ.

It is more likely that a second Reagan Administration will move toward a flatter income tax structure. That means, as the advocates point out, lower rates for taxpayers. The flip side of this approach, however, is that the tax base must be broadened in order to maintain the total flow of revenue to the federal government. Although flat tax proponents tend to soft pedal this aspect, it is vital. The extent to which tax rates can be cut depends primarily on how much the tax base will be expanded. In the move toward a flat tax, limits may be set on some current deductions from taxable income such as interest payments. Also, certain items not now taxable, such as employer-paid fringe benefits, may be added to the tax base, at least in part.

Most fundamentally, the ability of either party to cut tax rates depends on the willingness to control the growth of government spending. The likelihood of that occurring to any substantial degree remains slim.

A Second Reagan Term

Although it is interesting to speculate about the differences between a Mondale and a Reagan Administration, I would like to follow the polls for a moment and assume that Ronald Reagan is reelected. What is likely to occur?

Unless external circumstances change dramatically, I doubt if many major new domestic initiatives will be developed, at least in the White House. The President is satisfied that his economic program is working -- taxes have been cut, inflation is lower than almost anyone anticipated, and the economy is growing at a healthy rate. Thus, in a second term, the attention of the White House can and probably will shift, as it already has in part, to foreign policy matters. The rapid arms buildup will continue. Relationships with the

Russians may become even more difficult, but that area will also get greater attention than in recent years.

As for those budget deficits, the proposed constitutional amendment to require an annually balanced federal budget is looked upon as the major response. Given the short-term difficulties of cutting specific budgets, the constitutional approach is regarded as the only satisfactory long-term solution to the fiscal problem facing the United States. Meanwhile, Congress may take the lead in budget cutting, covering military as well as civilian programs. The results, however, are likely to be as modest as they have been in the last several years. During periods of economic growth, when incomes and employment rise, people are content with the status quo. Thus, only limited support can be generated for the painful actions involved in budget cutting. Of course, when business turns down, many advocates of economy in government agree that the time is not ripe for further curtailing demand by reducing federal outlays. Thus, the trend of rising government spending continues almost unabated.

Under the circumstances, I anticipate that tax reform in a second Reagan Administration will resemble "revenue enhancement." That is, despite the rhetoric, the tax burden on the average citizen will rise. However, that burden will remain below the level of 1980.

Conclusion

In summary, the differences between the economic policies of the two presidential candidates are often basic, and, in some specific areas, far wider than the current debate over deficits and tax increases indicates. Antitrust and labor-management issues, for instance, are likely to receive far different treatment depending on who emerges the winner on November 6.

Similarly, social regulation could once again become a growth industry under a Democratic President. Likewise, some form of industrial policy is far more likely to be introduced by Mr. Mondale than Mr. Reagan, but a healthy economy might well forestall any action in that area.

As some wag once said, forecasting is neither an art nor a science; it is a hazard. So all of these prognostications should be taken with a dose of salt. It seems safe to conclude that the outcome of this presidential election will make a significant difference in the direction of economic policy for the next four years.

In a nutshell, the variances between Mondale and Reagan can be summed up in terms of greater reliance on government decision making versus more emphasis on the role of private enterprise and on the private sector generally.