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Clintonomics: An Early Look

by Murray Weidenbaum

So far, Clintonomics is the mirror image of Reaganomics. President Reagan accelerated military buildup, President Clinton wants to accelerate the military cutback. Reagan cut taxes, Clinton wants to increase them. Reagan cut or slowed down many civilian government spending programs, President Clinton urges speeding up civilian spending. Reagan cut back on regulation of business, especially in his first term, while Clinton wants to increase it.

The changes being developed reflect the totally different views held by these administrations. Reagan looked to the private sector as the engine of growth, and reduced the burdens that government imposes on business. Clinton looks to government as the engine of change and views the private sector as responding to the signals, if not orders, from Washington.

But there is another way to look at the impacts of government policy. The United States is entering a period of change in public policy. Change brings both threats and opportunities, which means winners *and* losers. High-tech industries are a good example. The government is not really changing the amount it spends on research and development (R&D). It is cutting back military R&D contracts, creating difficulties for aerospace companies. But the White House is starting new high-tech civilian public-sector programs that will provide business for some electronics firms.

Those pluses and minuses are true for Clinton's entire budget effort. He advocates both spending increases and budget cuts. He urges tax rate increases and restoring some tax incentives. Let us run through the key elements of the Clinton program.

Infrastructure

The first item is infrastructure. Initially, it is the traditional construction programs — roads and bridges. These items have a large working class employment impact, but take

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some time to be effective. Perhaps a modest amount won't do much damage to the budget. But that's just the traditional part of the package.

A much larger proportion of the infrastructure money will go to create new public-sector markets. A "clean automobile," powered by batteries or hydrogen or methane, advanced recycling systems, high speed mag lev (magnetic levitation) rail networks, and a national information "highway" to link computers all over the United States are some of the proposed uses for this money.

The obvious beneficiaries will be companies who win those contracts. But there also may be lots of losers, notably the companies (like AT&T) the government may be competing against in the telecommunications market. It will depend on how the federal government structures its role. The Clinton Administration does not want the government to operate the network, but nobody knows what Congress will do.

Health Care Reform

Health care is bound to get lots of attention. Initially, Mr. Clinton is targeting the pharmaceutical companies. Medicine represents less than 5 percent of health care costs, but is often the most cost-effective part. The companies will be hurt by price controls. They may benefit, however, from the higher volume resulting from including drugs in the standard health coverage to be developed.

Clinton may resume his battle against the insurance companies and foster creation of broader health care networks (super HMOs). Hillary Rodham Clinton's task force is where the action is now. But identifying the problems is the easier part — high and rising costs, and lack of coverage. Dealing with that combination will be extremely difficult and providing universal coverage will raise medical costs substantially.

However, most of the larger and medium size companies already provide health insurance. Requiring them to do so is a pain but manageable. The small companies — who often do not provide this fringe benefit — are the major part of the problem. It is unlikely that many small businesses could provide this benefit without government subsidies. Excise tax increases are the obvious financing sources. If they don't raise enough, a value-added tax (VAT) is one unpopular alternative. Another is referred to as taxing employer payments for health care; actually, the proposal calls for disallowing portions above a fixed amount.

Slowing down the health care cost escalator is the real challenge. One possibility is expanded health maintenance organizations (HMOs), with a yearly fee per patient set by government. Supposedly that will force the HMOs to control costs. To me, it sounds like wishful thinking.

Another possibility is extending price controls beyond Medicare. Hospitals now shift costs away from Medicare patients. But if government sets fees for all patients, price shifting will become much more difficult. A likely outcome of the efforts to slow the growth in health care costs is longer waits and reduced quality of care.

Again, there will be pluses and minuses among sectors of the economy. On the positive side, there will be more business for expanded HMOs and more business for insurance companies if coverage is compulsory — unless there is competition from a government pool. There will be more prescriptions if Medicare covers medicines, but simultaneously, a squeeze on profit margins. Generally, low-cost providers should do well.

Defense Conversion

Defense conversion sounds like a free lunch. Who can oppose it? All the proponents want to do is to use some of the defense "savings" and generate civilian jobs for those laid off. All that sounds great — at first. On reflection, however, those defense savings are already pledged to reduce the deficit. Only in Washington can they spend the same money twice.

Of greater concern, the track record on defense conversion is dismal. The defense firms are very specialized. Making supersonic airplanes, ICBMs, and space vehicles takes special talent. These defense skills are not readily transferable. In their worst year, civilian-oriented firms do not try to enter this market.

Each major aerospace company has lost a substantial sum on efforts to diversify out of the defense-aerospace business. To increase taxes generally to subsidize more conversion efforts is wasteful. But that is no guarantee that it will not happen.

The defense companies themselves are smarter than the public policymakers. They have learned from experience. They are consolidating and cutting back.

Encouraging businesses generally to expand would be far more effective. They could draw on the unemployed workers. The training programs proposed by the Clinton Administration would make more sense under such circumstances. But government only does the right thing after exhausting all the other possibilities.

Government Regulation

One forecast is easy to make. Government regulation of business will rise rapidly. Actually, the rise started under George Bush. Regulation will expand more rapidly now. Vice President Gore is the point man and environmental regulation is the focal point. Mr. Gore really believes that more environmental regulation is good for the economy. He now is in the position to push this view.

There is a great deal of legislation already in the congressional hopper, such as a new clean water bill and expanding the endangered species law to protect "ecosystems." Proposed revisions of Superfund, the happy hunting ground for lawyers, are another example.

Next year will likely see a new hazardous waste disposal bill. That is RCRA, the Resource Conservation and Recovery Act. Who can be opposed to conserving resources? Mandatory recycling — aimed at packaging — is a real possibility for inclusion in the new bill.

All this new legislation will generate considerable business for the environmental firms — ranging from consultants to treatment facilities to working the EPA process for new permits. But that activity will divert capital funds from expansion projects and erode U.S. industrial competitiveness.

The environment is not the only area of expanding regulation. Members of compensation committees of corporate boards are becoming aware of the new SEC rulings on reporting compensation. It is another bonanza for paper pushers. Another challenge for corporations is considering how to meet new tax restrictions on executive compensation.

Nor should we overlook COSHRA (not an ethnic food). It's the proposed Comprehensive OSHA Reform Act. It would give individual employees "shut down" authority if they claim that a safety problem exists. Picture the consequences when a union contract is being negotiated.

There are other federal programs in the works. We will be hearing about education and training initiatives, housing, welfare, and aid to state and local governments. Some of these may be mandates on business, such as employee training requirements. Others will involve regulation, such as raising the minimum wage again.

Most of the new federal programs will require more federal spending. An example is giving people on welfare free child care. The idea is eventually to wean them off the public assistance rolls.

The administration's bid to create community development banks is reminiscent of the S&L fiasco. It won't cost much — at first. As for the notion of the federal government paying for 100,000 new police officers, I remember when that was a state and local function. That does not exhaust all of the possibilities, but it provides a flavor of what likely is ahead.

We should remember that the president sets the tone for the national debate. That means that the terms "deregulation" and "privatization" have been dropped from polite public discourse, at least for four years.

Taxation

Most Americans' tax bills will be rising in the years ahead. Of course, that comes as no surprise. For many citizens, that involves adding insult to injury. I have in mind the frequent charge that the rich do not pay their fair share of taxes. That is pure baloney. According to the latest data, the top 5 percent of households pay 43 percent of the federal income tax, while the top 25 percent pay 78 percent of the federal tax. In striking contrast, the lowest 50 percent of the income distribution pays 6 percent of the income tax, and the bottom 25 percent pays less than 1 percent.

With all the talk about a low-saving society, the administration wants to sock it to the high-saving brackets — and they likely will. That includes new restrictions on tax-deductible contributions to corporate retirement funds.

Some people may wonder why the White House emphasis is on tax increases rather than spending cuts. It is important to understand how Washington works. Of course, President Clinton is right when he talks about the power of interest groups. Tax legislation does bring out many of them in full force. However, contrary to public perception, business groups and trade associations such as the American Petroleum Institute (API) or the American Mining Congress (AMC) are not the real powerhouses. If they were, they likely would have killed the proposed energy tax because it hits oil and coal companies especially hard. But API and AMC know they can only influence the details.

The real power in Washington, DC, is in the lobbies on the spending side of the budget. The American Association of Retired Persons (AARP) is a powerhouse on entitlements. So is the Farm Bureau on agricultural subsidies, and the unions on the Davis-Bacon Act and job safety regulation (OSHA). Similar legislative strength is shown by the veterans groups on veterans benefits and the environmental groups on EPA issues. No business group — or combination — can match them in terms of the ability to influence the course of government policy. That is why government spending continues to be a major growth area of the U.S. economy.

An Initial Evaluation

For the next four years, the United States is going to have a far more activist federal government. There will be much more government regulation, especially in the environment area and substantially higher business and upper income bracket taxation. In addition, government spending programs will proliferate. However, the new or expanded programs will not be the traditional entitlements which bolster consumer purchasing power. Rather, the major initiatives will be an extension of civilian government markets.

This shift will create opportunities for many industrial-oriented companies, such as construction firms, high-tech manufacturing industries, and consulting firms in the environmental, training, and safety areas. Other beneficiaries will be non-profit organizations involved in planning local defense conversion efforts and training specialists and others who can penetrate niche markets in the public sector.

A more active government role in international trade and investment is also likely. There will be a return to legislative approaches like super-301, which are designed to open up overseas markets to American companies. More bilateral deals are also likely, since the Department of Commerce and Trade Representative's offices are headed by lawyer-lobbyist-negotiators.

The tax system will be used to control the flow of foreign investment into the United States. Also, high-tech policy (newest term for industrial policy) will be relied on to enhance the competitiveness of selected U.S. industries.

Despite promises of laser-beam concentration on the domestic economy, there will be periodic worries about foreign policy hot spots. There will be no shortage of these in Europe, Asia, Africa, and Latin America. Americans continue to live in a dangerous world and the defense budget will not evaporate.

On balance, President Clinton will enjoy an economic honeymoon through 1993 and maybe into 1994. In part, that is because our national expectations have been lowered and, like President Reagan, he communicates very well. But this is only the second month of the Clinton presidency and surprises are likely in store.