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Confessions of a One-Armed Economist

by Murray L. Weidenbaum

CENTER FOR THE STUDY OF AMERICAN BUSINESS

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Introduction
Introduction

President Harry Truman was supposed to have said in desperation, "I am tired of all the economists who always say, 'On the one hand and, then again, on the other hand.' Send me a one-armed economist." Although Paul Samuelson once responded that a one-armed economist is a cripple, this report is an effort to supply serious answers, without much equivocation, to some of the key issues facing the American people. In the spirit of Harry Truman, it will have a minimum of hemming and hawing. It is not meant to be a textbook on how to be an economist, but rather a guide to a number of today's important economic questions.

What are some of those key matters? As I travel around the country and speak to a wide variety of groups, some of the questions I am regularly asked are the following:

- Can the U.S. government ever control the federal budget? Are those $200 billion deficits inevitable? Why doesn't Congress cut all the waste and inefficiency out of the budget?
- Can we do anything about military spending? If everyone knows about the waste in the Pentagon, why can't anyone stop it?
- Are America's smokestack industries really going down the tube?
- What are we going to do about foreign competition? How can we possibly compete against cooley wages and foreign government subsidies?
- Why is the government trying to cut my Social Security? After all, I paid for it.
- Who are all those special interests we hear so much about?
- Why is American education going downhill, even though we are spending more for it?
- Is "Reaganomics" working? And if it is, what does it mean for the future of the economy?
- Shouldn't our economy be more centrally planned? Don't we need a U.S. MITI in order to beat the Japanese at their own game?

Dr. Murray L. Weidenbaum is Director of the Center for the Study of American Business and Mallinckrodt Distinguished University Professor at Washington University in St. Louis. He is a former Chairman of the Council of Economic Advisers. Editorial assistance was provided by Ronald J. Penoyer.
Isn't a large part of the problem with American business the stupid decisions made by management?

Has the regulatory apparatus really changed much under the Reagan Administration?

What can individual citizens do to protect themselves—or to change things?

And the inevitable question: if you are so smart, why aren't you rich?

The following essays deal with diverse economic issues such as these—except for the last!—with which I have been concerned over the years. I have tried to keep each essay short and to-the-point. The first section deals with several important issues that affect private enterprise in America today—ranging from the record-high federal budget deficits, to current discussions of the need for a national "industrial policy," to the demands made on businesses by corporate activists.

The second section surveys problems in the world economy, particularly the resurgent sentiment for protectionism. It also contains an analysis of a new form of international regulation of business in which the United Nations is involved. The third section contains essays on various aspects of government regulation, an economic issue that I have studied for a number of years.

The final section of this report presents assessments of where we stand in a decade of important economic change, as well as a prognosis of where we are headed. The challenge we face in economic policymaking in the 1980s is a matter of making hard decisions and avoiding easy answers. On this score, I remain optimistic. I am impressed at how much nonsense we have unlearned—some of it very recently—and how many old and more modest, but harder, truths have been confirmed.

Those truths often are in need of reaffirmation, since our concern with the free enterprise system in the United States is part of a larger national debate over fundamental values. It behooves us, in short, to relate economic issues—which often seem transient or limited in scope—to the broader interests of the public. We tend to lose sight of the fact that the close correspondence between economic freedom and personal liberty is not accidental. If we find it hard to be convinced of that fact, we need only spin the globe and take a good, hard look.

Taken as a whole, these essays are intended to reflect a concern not only with our economic system, but also with our more basic desire to maintain and strengthen the free and voluntary society of which the economy is a vital but only constituent part. In fact, the shortest essay I could write would simply state that political freedom requires economic freedom. We foster one as we pursue the other.

I. Key Issues Facing Private Enterprise
Anyone traveling around the country, especially the older industrial areas of the Midwest, increasingly encounters a feeling often approaching despair. Clearly, there is genuine reason for concern about the future in regions of high unemployment and declining sales. But I did not expect to find so many employed people and profitable companies joining in the talk of doom and gloom. So many of them now worry that manufacturing industries are all going down the tube, that only high-tech companies and knowledge workers will have a role in tomorrow's economy. What is the basis for this expectation? It turns out that there is currently a bull market for "big thinkers" who express their thoughts in dramatic absolutes.

In widely circulated books and magazines, the big thinkers blithely tell us that the industrial era is over, that we are now living in an economy which is based only on the creation and distribution of information. On reflection, taking such overstatement at face value is just silly. Are we going to eat information, wear information, house ourselves in information?

Of course, the so-called knowledge industries or research-intensive companies are key growth sectors of the economy. But decades before we learned the buzzword "high-tech," these were already the dynamic parts of our society. Just as surely, however, the production of goods will not wither away. After all, we will still need machines to produce and distribute knowledge and information.

Moreover, major non-manufacturing industries (often called the "service" sector) are important customers for the output of manufacturing corporations. Utilities and airlines are obvious examples of capital-intensive, non-manufacturing operations. To the many executives in industrial firms who fear for their future, I urge them to discount the bloated vocabulary of the big thinkers who tell us that yesterday is over, that there are just two sectors of the economy (sunrise and sunset companies), and that we are becoming a microeconomic information self-help society, characterized by a galaxy of networking constellations. We must label such meaningless collections of buzzwords as Megabaloney!

Of course, stripped of the rhetoric, there are serious problems facing industrial corporations—but they are solvable. However, these problems will not fade away by blaming "unfair imports" and by running to Washington for help.

Many manufacturing companies have to deal with two related but incompatible trends—falling productivity and rising operating costs. When we compare, for example, U.S. and Japanese production experience, the results are very revealing. A study of the U.S. and Japanese automobile industries reveal that their absenteeism rate is 3 1/2 percent and ours is almost 12 percent. Their labor turnover is 2 percent and ours is 15-20 percent. We cannot blame our poor labor practices on foreigners. It is no tribute to
either managerial leadership or worker conscientiousness when a large U.S. manufacturing company has to give a bonus each time an employee puts in a full work week! It is no surprise that this company is losing its share of world markets.

The industrial heartland of our nation surely needs to be strengthened. But that does not mean propping up industries via import restrictions or government subsidies—or preventing them by law from closing down or "running away." Rather, labor and management in each company need to face the challenge of greater productivity and enhanced competitiveness. Management must show the way. Cutting back on the proliferation of staff activities and layers of executives creates an operating environment in which changes in needlessly costly workrules can be made and wage rates and fringe benefits brought back to reality.

No, the sun is not going to set on U.S. manufacturing companies. In fact, it will rise on those that make the hard decisions that bring productivity up and costs down. And that's not megabaloney.

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Discount the bloated vocabulary of big thinkers who tell us we are becoming a microeconomic information self-help society, characterized by a galaxy of networking constellations.

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Fallacies of "Industrial Policy"

As predictable as Spring crocuses, the high level of unemployment has led to pleas for an "industrial policy" to restore the health of the American economy. By guiding investment into growth areas and out of declining markets, a new federal industrial policy supposedly will restore the competitiveness of American business at home and abroad. What is especially disconcerting about this development is the number of business executives who are joining in this chorus for more governmental intervention—these are men and women who normally champion private enterprise and oppose a bigger role for Uncle Sam in business decision making.

One of the focal points for the advocates of industrial policy is the proposed reestablishment of the Reconstruction Finance Corporation (RFC), a creature of the Depression of the 1930s that grew rapidly during and following World War II. Those with short memories may think well of that government enterprise, but a review of its activities is instructive for today's situation. Under the original act passed in 1932, Congress granted the RFC very modest lending powers limited to railroads and financial institutions. During the next six years, however, the agency's authority was steadily broadened. By 1938, it had the power to buy the securities of any business enterprise. Although it may have made a useful contribution during the Depression and World War II, the RFC made most of its loans to business in the postwar boom period of the late 1940s and early 1950s.

By 1949, rumors circulated that connections with influential people in Washington were often the real criterion for gaining loan approvals from the RFC. Congressional hearings disclosed numerous examples of favoritism in the granting of RFC loans. Finally, in 1953, Congress ended the life of this now discredited agency. The history of the RFC shows that government subsidy of business encourages and perpetuates a misallocation of resources. The agency's loans included such "high priority" ventures as distillers, brewers, drive-in theaters, hotels, motels, and bars. The RFC experience also demonstrates that government programs develop a life of their own and persist long after the problems for which they were created have been solved.

Variations on the negative theme of focusing on the "losers" are not limited to the notion of bringing back the RFC. Some would attempt to stop economic change by dealing with the so-called "runaway plant problem." Their response is to make it extremely difficult and costly to move or close down an industrial facility. This "King Canute approach" ignores the reasons why companies are forced to take such actions in the first place. So frequently, those plants have lost their competitiveness due in large part to the government policies advocated by the same groups that now support legislation preventing factory closings. Such proposals also overlook the negative signals that this policy would send out to any company considering
building a new plant in a region that has adopted restrictive legislation (and a few states have already done so).

All this, however, need not lead to a "do nothing" approach to the serious economic questions that face the United States. There is a growth strategy that involves no expansion in either government power or federal spending. Its elements are basic—tax simplification, regulatory relief, lower deficit financing, and curtailed government lending. In each of these areas, much needs to and can be done.

Although the 1981 tax reductions were surely welcome, the tax code is far more complicated today than it was just a few years ago. Simplification is especially important to the smaller firm. Similarly, the recent regulatory relief effort has accomplished much in reducing the burden of new rules. But fundamental improvement can come only from revising statutes that mandate unreasonable compliance burdens, such as the "zero discharge" goal of the Clean Water Act and the "zero risk" provision of the Delaney Amendment to the Food, Drug and Cosmetic Act.

It is ironic to contemplate the numerous industrial-policy proposals for funneling federal funds to "worthy" private investment areas at a time when the federal government is running budget deficits of $200 billion a year. The most effective way to increase private capital formation is to reduce the federal drain on private saving represented by massive deficit financing.

Finally, federal lending programs are a classic example of robbing Peter to pay—or lend to—Paul. They do nothing to increase the pool of private saving, but reduce the amount available in the private market. The most effective strategy for encouraging economic growth is well known—reduce government barriers to competition and achieve a better functioning market economy.

A growth strategy involves tax simplification, regulatory relief, lower deficit financing, and curtailed government lending.

Corporate Activists: Politicizing Business

"Truth-in-labeling" is a concept with which every business executive has become well-acquainted. Yet it is ironic that many of the organizations and individuals that fought for the enactment of such statutes would flunk the most elementary truth-in-labeling test themselves. Take the example of the "corporate activists!"

Judging by their self-designated title, you would expect that corporate activists were engaged in the worthy enterprise of attempting to energize a sluggish company or were concerned with improving the economic performance of American business. Nothing could be further from the truth. The typical "corporate activists" are oblivious to the economic role of private enterprise. Producing and distributing the goods and services that meet consumers' needs is too humdrum a task to attract their interest.

Rather, they see the resources of the private enterprise system as a means for achieving their social ends. One term they love to use is corporate or economic democracy. But, on the contrary, they refuse to abide by the decisions of this nation's democratic political processes. They will buy a few shares of stock in a company—not as an investment—but to use the annual meeting as an opportunity to try to force the company to follow their pet social or political goals. These are goals which they are unable to convince Congress to adopt—such as an embargo of trade with specific nations or imposing our internal social standards on other countries.

Thus, it is not surprising that, in recent years, shareholders in company after company have overwhelmingly voted down proposals such as one which would have required a company to invite a writer on solar energy to speak (at the annual meeting) on alternative energy sources. Imagine the waste of time and money involved in processing such a frivolous request—or the presumptuous proposal to prohibit a cigarette producer from selling its products in a country where the government does not warn against smoking. Those "activist" shareholder resolutions cover a wide variety of issues: limiting or prohibiting business in South Africa, controls over consumer marketing in the developing nations, and restraints on plant closings or relocation.

Some of the activists' shareholder proposals involve great detail. One would require a company to report on the environmental impact of a project in Brazil. Another would have a bank stop lending to Guatemala. Still another would require a company to report on a plant closing in South Korea, providing an analysis of its employment practices.

Not all the activists are on the left. Prohibiting trade with Communist nations is a perennial proposal by activists on the right. These proposals would require either ending trade links with Communist nations or adopting company policies to avoid buying or selling goods involving organizations engaged in "slave labor."
All these proposals share a common, fundamental defect: they would politicize basic business actions. Buying and selling goods and services would become political acts, to be debated at annual meetings by groups that have no interest in the firm's welfare. Each company would be forced to adopt and pursue its own notions of what should be our foreign policy, environmental policy, and so forth.

Fortunately, the great majority of individual shareholders and institutional investors have more wisdom. They consider some of these matters as proper for government, but not for business decision making. The proper response to the various “activists” should not be the patronizing one of saying, “they are well-intentioned, but ....” Wittingly or not, these efforts to politicize the business system would weaken the economy’s performance and reduce support for the private enterprise system. Viewed in this light, stockholder resolutions introduced by most activist groups are anything but well-intentioned and should be vigorously opposed!

"Corporate activists" see the resources of the private enterprise system as a means of achieving their social ends.

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**How to Keep Income Tax Indexation**

Continuing deficits in the federal budget in the range of $200 billion annually reflect our inability as a nation to make tough decisions and to choose among alternatives—each of which has strong attractions. The adamant defense of retaining the scheduled indexing of the federal personal income tax in 1985 is an important case in point. As a means of reducing “bracket creep” and eliminating the government’s gain from inflation, indexing the tax structure is, of course, an inherently desirable type of tax reform. In fact, many of us used that argument in urging the Congress in 1981 to enact the Economic Recovery Tax Act which, in its amended form, included this provision.

Yet it is clear that tax reduction—and, despite all the obfuscation, tax collections will be lower with indexing—is part of the deficit problem. We have learned the hard way that, despite a great deal of wishful thinking to the contrary, cutting revenues does not automatically lead to reduced government spending. In fact, since the enactment of the 1981 tax law, the expenditures of the federal government have continued rising faster than the economy. In real terms, the spending path is almost indistinguishable from the one traced out in President Carter’s swansong budget message.

We must reluctantly acknowledge the sad fact that across-the-board income tax rate reductions do indeed increase deficits. Those of us who are committed to a smaller public sector must focus our efforts on the more obvious but difficult approach—directly reducing the flow of government spending. And, thus, we see that there is no substitute for getting Congress to appropriate less in the first place.

It is discouraging to note how many of the proponents for retaining tax indexing pay only lip service to the need to slow down the rapid upward trend of government spending. They assure us that they are staunch advocates of smaller budgets. But so many of them fall by the wayside when specific budget cuts are proposed, protesting that entitlements are too difficult to cut, defense spending is politically too important to cut, and the other categories are too small to mess with.

In a very real sense, we have not earned the indexing of the federal income tax structure. If we are to avoid losing that desirable reform of the tax system, we must begin another round of comprehensive budget cuts. We must not be distracted—as was the case last year—with proposals to increase Social Security taxes, excises, tariffs, etc.

That highly necessary round of budget cuts should aim at achieving the traditional goal of federal budget practice: good budgeting is the uniform distribution of dissatisfaction. Alas, not enough federal departments and agencies—and their private-sector allies—have become dissatisfied by the budget cuts that have been made so far. The rationale for shifting from the 5 percent annual real growth in military spending, which was a key point of
the 1980 Presidential campaign, to 10 percent remains unexplained. Surely, our military posture has not deteriorated in these last two years.

Likewise, accelerating Social Security tax collections is no substitute for meeting head on the basic shortcoming of the federal government's "social insurance" programs: the benefit payments are far in excess of what an insurance program would be expected to provide—that is, benefits based on the payments by employees and their employers, including the earnings on those contributions. Although the term is upsetting to many, the hard fact is that the major portion of the average recipient's monthly Social Security check is the economic equivalent of welfare, a compulsory transfer of purchasing power from somebody else to the recipient.

Nor should the remainder of the federal budget escape tough scrutiny. A host of subsidies to special interests—sugar producers, dairy producers, ship builders, ship operators, exporters, and energy producers, to mention a few—remains in the federal budget. Each one of these items is an attractive candidate for elimination.

However desirable as a tax reform, we should be careful not to claim too much for indexing of the tax structure. For example, some proponents claim that eliminating the indexing provision would produce a powerful incentive for Congress to force the Federal Reserve System to follow an inflationary monetary policy. There is no need to guess what the response would be. In 1981-82, in the absence of an indexed tax system, the Fed did indeed pursue a deflationary monetary policy. The notion that the primary motivation of the Congress in the monetary policy area is to inflate the currency in order to reduce the deficit is just plain silly. It flies in the face of experience; if anything encourages excessive stimulation, it is the response to high unemployment.

Similarly, the idea that repeal or postponement of indexing would immediately lead to a rise in long-term interest rates and a weakening of the recovery sounds quite divorced from reality. Passage of the indexing provision surely did not lead to a decline in long-term rates or to a strengthening of the economy's growth rate—nor did it cure baldness! If anything, financial markets will respond very positively to the prospect of lower deficits.

Boiled down to its essentials, the case for postponing the indexing of the federal income tax system is one of avoiding instant gratification. We need to cut spending first in order to justify the move to indexing at a time of massive deficit financing. Such reductions in government outlays would make the retention of indexing more likely. Moreover, under such new circumstances, indexing would become an attractive way of developing pressure to maintain a lower federal spending level well into the future. Yet, surely we must lower spending first. The lessons of recent economic policy and practice are clear: lower taxes do not achieve lower government spending levels; rather, lower spending permits the responsible reduction of government tax schedules.
Dollars vs. Incentives in Education

It has become fashionable to bemoan the inadequacy of federal spending on education. Some attention to this important area is surely warranted. When we probe beneath the surface, however, it becomes clear that the problem of educational quality in the United States is not primarily a question of the amount of money devoted to this purpose but how we spend it.

In 1974, the Federal Government disbursed $4.6 billion for aid to elementary, secondary, vocational, and higher education. In 1983, the budget estimate for educational assistance is over $13.3 billion, almost three times as much as the amount spent at the beginning of the decade. During the same period, we have seen substantial deterioration in the measured performance of students. Clearly, simply spending more money on education is not sufficient. This is not a justification, however, to spend less on our schools. Rather, experience underscores the need to improve the effectiveness with which the funds are used.

My suggestion is to stress the role of incentives—incentives for both students and teachers. For students, we need to provide incentives to perform. Blithely promoting students on the basis of their age and giving them (I use that verb advisedly) a high school diploma when they hit 18—regardless of their academic performance—provides no incentive to work hard.

When I was in Florida recently, I observed the fierce discussions aroused by the State's new policy of issuing a high school diploma only when it is earned. I was particularly impressed by the statement of one high school principal that the students in his school moved from way below average performance on the statewide tests to substantially above average only after the school began to stress the need for performance. For many if not most of us, studying is hard work. Why do it if you get promoted and graduate whether you apply yourself or not?

By the way, I read some of the questions in Florida's new statewide testing program. That was quite an eye-opener. One question was roughly as follows. It showed two clocks, one at 1:50 and the other at 2:10. The student was told that when Joe came in the room, the clock was in the first position, and when he left it was at the second position. The question was, "How long was Joe in the room?" To those who criticize such basic attempts at performance testing, I must reply: How can we expect a young new worker to get to the job on time if he or she cannot even tell time? How can a person even get the job if he or she cannot fill out the application form? The links between education and incentives and productivity are very strong.

Likewise, incentives can play an important role at the teachers' level, too. That approach could help alleviate the shortage of math and science teachers. In an economy with a rising need for people with mathematical and scientific skills, how do we encourage more people to go into those fields?

The answer is not very complicated. We pay them more.

But try doing that at the high school level. The reaction is predictable: howls of outrage. "Aren't gym teachers and social studies teachers as worthy as math and science teachers? Why should they be paid any less?" I do not mean to be offensive, but frankly, that attitude betrays economic illiteracy. Income is not a matter of inherent nobility. Indeed, it is a matter of attracting people to the areas of work in which they are needed.

The links between education and incentives and productivity are very strong.

If colleges and universities paid science teachers and classics teachers the same, we would have a chronic shortage of physicists and a surplus of Latin professors. The prospect of higher pay is an important factor in encouraging more students to major in physics and math. Standard, across-the-board pay increases for teachers may seem to make the administrator's job easier, but that only worsens the shortage situation. Far more important, the old-fashioned approach to teachers' pay short-changes the student.

The introduction of incentives will not be easy. The idea goes counter to the oldest bureaucratic argument for the status quo: "that's the way we have always done it." But given the realistic alternatives, greater use of incentives is an effective way of strengthening the educational process and improving the performance of our young people—not only in school but throughout their careers.
The Federal Budget Quandary

Polar alternatives and dramatic extremes are always likely to attract public attention. Discussions of the finances of the federal government are no exception. On the one hand, there are many economists and others who contend that budget deficits do not matter at all. They cite as evidence the current robust recovery in the face of an estimated $200 billion of federal borrowing.

On the other hand, there is no shortage of financial and economic authorities who point to the same deficit as the fundamental source of high interest rates, the large foreign trade deficit, declining business investment, and other economic problems.

Neither extreme is an accurate description of reality. The more likely outcome—as is so frequently the case in economic disputations—is in that unattractive and dull middle position. When the government runs a deficit, that does make a difference. But surely deficits are not the only thing that matters. The underlying strength of the private sector is far more basic. In the short run, money supply changes swamp fiscal effects. Moreover, the impacts of government spending and deficit financing vary over time.

In fact, time is the key. In the short run, a strong recovery in the economy is underway. According to my foggy crystal ball, this recovery will last at least until the polls close that Tuesday in November in George Orwell’s year.

But there are clouds on the economic horizon. As citizens, we should be concerned about dealing with them right now. As business executives, we should crank that into our long-term planning. There are two major and overlapping clouds—the possibility that monetary policy will stay too easy too long, and the danger that fiscal or budget policy will continue to generate large deficits even as the economy continues to recover.

In the monetary policy area, I hope that my standard analysis of the Federal Reserve Board’s actions in the past is not appropriate once more. Too much, too late. Combined with the budget deficits, we seem to be witnessing a version of conventional Keynesian stop-and-go policies, but without those pejorative labels. Personally, I believe that fiscal policy shortcomings constitute the basic culprit, and I will dwell upon them in a moment.

Monetary policy, at least for 1981 and 1982, bore the responsibility for bringing down the inflation—and bringing down employment, too. Since then, monetary measures have been the major engine of recovery, but I hope that the Fed does not overdo the stimulus.

The Initial Reagan Economic Program

In order to understand our current budget problems, we must go back to the beginning—that is, to the beginning of 1981. On February 18, 1981, President Reagan, in a major economic address, presented to the nation his
Progress on the Reagan Budget

Let us return to the budget quandary. The Administration's original tax proposal was to reduce the personal income tax by 10 percent a year for three consecutive years and to liberalize depreciation allowances. In an effort to decrease the deficit, the first installment of the proposed personal tax cut was reduced to 5 percent and postponed three months. But in the subsequent negotiations with the Congress on the tax bill, a "bidding" war occurred.

The result was to see the addition of many expensive and extended provisions added to the tax bill. These ranged from the temporary all-savers certificates to the permanent introduction of indexing. Other add-ons including increasing the attractiveness of Individual Retirement Accounts and reducing the marriage tax penalty. The financial markets interpreted all this as meaning an extended period of deficit financing. The resultant rise in interest rates directly increased the budget deficit. To the extent that it exacerbated a weakness in capital-intensive sectors of the economy, the rise in rates also indirectly contributed to higher deficits in the budget.

But what about all the spending cuts? One of the saddest but most revealing analyses is a comparison of President Carter's budget plans with President Reagan's. On the surface, the growth in federal spending has been slowed down. But, on inspection, the slowdown was virtually entirely the result of lower inflation. Recasting the analysis in real terms is quite an eye-opener. When we compare the projections of spending for 1982-86 in President Carter's swansong budget with President Reagan's current numbers, we find that the differences are very small in real terms. In fact, it depends on which price index or deflator you use as to whether you find the Carter or the Reagan real spending numbers to be lower. This finding may come as a surprise to those who read so much about all those budget cuts. But we must also take account of the continued rise in the "entitlements," in farm subsidies, and in military procurement.

I do not criticize only the Congress or the Administration. There is plenty of blame to go around. After all, it was the President who submitted the $200 billion deficit budget—and it is the Congress that is going along with it. We truly are a democracy, with a small "d" of course. The people we elect do represent us. When you get down to basics, it is the average citizen who generates the pressure for more government spending. And please do not kid yourselves. You do not get off the hook by saying, "I'm all for economy in government, but...don't cut the special project in my area or the one benefiting my industry, because that is different. That is an important contributor to economic growth, etc." I still vividly recall my meeting with the representatives of an interest group pleading for a handout from the government. When I said, "That's the equivalent of welfare," they protested vehemently. Their unforgettable response was, "Welfare is for poor people!"

The Budget Outlook

I am not saying that budget deficits are good for us. The American economy would be a lot healthier if the deficits were half their present size. But it seems clear that expansive monetary policy can, for a while, overcome much of the depressing effect of sustained deficit financing. But only for a while, and not completely.

We are going to pay the price for those large deficits—in terms of higher interest rates, larger balance of trade deficits, and lower economic growth

We are going to pay the price for those deficits—in terms of higher interest rates, larger balance of trade deficits, and lower economic growth than we otherwise would have. But that is different from forecasting economic doom and gloom. With an expanding economy and rising pool of saving, those deficits will, over time, shrink in importance in both absolute and relative terms. But to the extent that they force the Fed to maintain excessive stimulus, the deficits contribute to another round of inflation. Meanwhile, housing and business investment will increase more slowly than would otherwise be the case. Thus, economic growth and the rise in living standards will be modest—if we take the unlikely course of engaging in another round of comprehensive budget cuts.

I have become truly nonpartisan on this matter. When the Republicans want to cut the social programs, I am with them. My service on the Budget Working Group convinced me that there are many further opportunities for economy in government—in every department and agency.

Yet when the Democrats want to shave the rapid defense buildup, I am also with them. My studies of the defense industries convince me that production bottlenecks may be likely in the years ahead, when rising business investment and expanding weapons production compete for the same limited resources. Unfortunately, the history of defense production tells us that crash programs usually crash—or they get cancelled. By the way, that is not poetry. In 1980 (the only year for which such data are available) most of the weapons programs with big cost overruns were cut back. Hardly any that stayed close to their targets suffered reductions in orders.

There is also no reason to maintain, for the indefinite future, a policy that encourages members of the armed forces to retire in their early 40s and receive generous pensions while actually working in civilian employment—and then also qualifying for one or more additional pensions. So much for the notion that it is unpatriotic even to contemplate cutting the military budget.

I part company with both sets of budget cutters, Republican and Democrat—because they both want to apply the savings from their budget cuts to offset the cuts made by the other party. We need genuine reductions, not
just a reorientation of federal spending. Remember my favorite advice to Congressional committees, "Don't just stand there, undo something."

I have no panaceas to offer—other than the strong belief that there are no panaceas. Beware of the easy answers. Salesmen notoriously have weak sales resistance, and it is sad to note that dynamic business leaders tend to demonstrate their sense of social responsibility by uncritically accepting the popular buzzword of the day. If supply-side economics did not solve our ills, neither will the adoption of an "industrial policy" nor a return to the gold standard. The budget quandary represents our unwillingness as a nation to make hard choices—and the natural reluctance of our elected leaders to keep our feet to the fire—and vice versa. If there is anything that I learned during my recent tour of duty in Washington, it is that Pogo was right. "We has met the enemy, and they is us."

The Defense Buildup: Is It Feasible?

The second largest category of outlays in the U.S. budget, after the so-called "entitlement" outlays, is national defense. Here we should acknowledge at the outset that there is a broad-based agreement on the need to expand U.S. national defense spending. Both the Carter and Reagan budgets projected significant growth in defense spending, in real terms, for each of the five fiscal years 1982-1986. As the Council of Economic Advisers stated in its annual report accompanying the President's Economic Report of February 10, 1982, "any economic effects... must be assessed in the context of the overriding need for maintaining the level of defense spending necessary for national security."

Official projections of future defense outlays, after adjustment for inflation, have risen successively during the last two years from 5 percent to 10 percent per annum. I find little justification offered of the economic feasibility or of the military necessity of this sharply upward movement. A tough-minded attitude should be taken to the military budget, comparable to the treatment of many civilian spending activities of the federal government. Because of the potential capacity problems, a given cutback in nominal military spending would actually result in less than a proportional reduction in real procurement outlays. This would come about because of reduced price pressures on military purchasing generally.

As would be expected, there has been considerable disagreement over the specifics of the buildup, including how rapid an expansion in military spending is desirable. But none of this is a debate between hawks and doves. Among the specific questions raised is the economic feasibility of the currently contemplated schedule of military outlays. Moreover, the 1981-82 recession has resulted in such substantial amounts of excess capacity in American industry that, at least for the next year or two, there is likely to be adequate capacity to meet military and civilian needs. But it is useful to look beyond, to the middle of the decade, when significant economic growth may coincide with the peak of the military buildup. In such circumstances, capacity questions would arise and three results of the defense buildup can be anticipated:

1. The substantial transfer of resources in the durable goods sector to defense production may increase prices in key industries. Both the Department of Defense and private purchasers would have to pay more for goods purchased from these industries. This premium is likely to increase with the size of the defense budget.
2. Increased demand may produce delays in the delivery of military goods. Delivery time tables that seem realistic today may become obsolete as producers try to accommodate both the defense buildup and the expansion in civilian investment.
3. Some crowding out of private investment may occur. Defense procure-
ment uses many of the same physical resources needed for private investment, and the law gives defense priority in the marketplace. Some private firms may turn to foreign sources, while others may cancel or postpone plans for expansion.

When we examine the details of the military budget, we find that the concentration of the planned military increases within the categories of procurement and research and development implies weapon production growth rates even more rapid than those which occurred at the peak of the Vietnam buildup. Moreover, the present expansion occurs after a decade of steady reductions in the defense industrial base.

A private economic consulting organization, Data Resources, Inc. (DRI), points out that "the combination of the increasing defense shares and the acceleration in growth rates raises concerns about industrial capabilities and spillover impacts on the economy." DRI goes on to note that, with the implementation of significant investment programs in both plant and equipment and skilled labor forces, the problems of price pressures, bottlenecks, and crowding out of civilian demand "could be constrained to isolated instances." Over the six-year period 1982-87, double-digit increases in annual output are shown for many industries, ranging from semiconductors to computers. I share the DRI conclusion that uncertainties about the capabilities of the defense industrial base, and its linkages to other critical economic variables, will continue to cloud decisions regarding the defense budget.

Since 1948, there has never before been a period of sustained growth in real defense spending such as that now planned. The projected requirements for such large increases in defense output raise obvious questions about the ability of industry to meet them without adverse implications in terms of costs and leadtimes. A recent study by the U.S. Department of Commerce reminds us that defense expenditures do not affect all industries equally, but have "highly concentrated industrial impacts."

For most of the 58 major defense supplying industries Commerce studied, the Department reported that existing capacity and planned increases are sufficient to supply the projected military and civilian demands through 1985. However, the Department said that, should further capacity expansion not take place in some of these industries, meeting projected 1985 requirements would mean using outmoded, economically inefficient capacity, which would increase costs and prices. In any event, there are a few potential bottleneck areas. For example, requirements for lead smelting and refining are projected to rise by 12 percent from 1979 to 1985, but economically efficient capacity is estimated to decline by 4 percent. Likewise, requirements for brass, bronze, and copper foundries are shown to increase by 32 percent, but economically efficient capacity is expected to rise by 25 percent. How will all this balance out?

Some of our basic metal processing industries will likely increase their dependence on foreign sources of supply in order to meet the stepped-up military demands. For example, the electrometallurgical products industry (which was specifically noted by the Commerce Department because of its "qualitative importance to defense") met 27 percent of its needs with imports in 1979. That key industry is expected to increase its dependency to 45 percent in 1985. Likewise, zinc smelting and refining is anticipated to increase its import dependency from 33 percent in 1979 to 45 percent in 1985. Imports of miscellaneous, refined nonferrous metals are estimated to comprise 66 percent of the industry in 1985, compared to 56 percent in 1979. It is ironic to note the matter-of-fact way in which the Commerce Department reports such increased foreign dependence for some of the key defense-producing industries. On many other occasions, the hoary national security argument is trotted out to justify a host of subsidies to sectors of the economy far less closely related to defense output.

An important implicit assumption arises from these concerns: any adjustment of scheduled defense outlays to conform more closely with expected domestic production capabilities would result in slowing down the rate of increase in defense spending in the next few years and, thus, lower the projected budget deficits.
II. The Global Economy
A Positive Approach to Trade

As a nation, we love to pay lip service to the advantages of free trade. Nevertheless, the United States seems to be moving back toward protectionism. Public policy debates are now dominated by one-sided, self-serving views of international trade. Everyone wants open markets and free trade overseas; we all know how urgent it is to eliminate "their" barriers to our exports. But United States barriers to their exports do not generate much interest over here.

Let me explain this with a very basic example—Country A and Country B. Country A is on one side of the ocean, and Country B is on the other. Country B has a large export surplus with Country A, and Country A experiences great difficulty getting its exports into Country B. Sounds familiar? Of course, Country B is Japan (big trade surplus) and Country A is the United States (big trade deficit).

But that is not the end of the story. When we take another look, we find that Country B (big trade surplus) is the U.S. and Country A (big trade deficit), Western Europe. Over the last decade, we have had a large trade surplus with the European community, almost as large as our deficits with Japan. And we have erected an array of obstacles to imports into the United States. Although many Americans are agitated over our trade deficits with Japan, how many are even aware of our large trade surpluses with Western Europe? It is not surprising that, given this difference in awareness, protectionist pressures are on the rise.

U.S. Barriers to Imports

It would help to clear the air in international trade discussions if the United States were to acknowledge that all of our actions are not on the side of the angels. We have created many obstacles to inhibit imports into the United States.

"Buy American" statutes give preference to domestic producers in government procurement. As much as a 50 percent premium is paid for domestic production of military goods. In addition, American materials and products must be used for purchases over $500,000 under the program of aid to mass transit. Also, American flag vessels must be used to ship at least 50 percent of the gross tonnage of all commodities financed with U.S. foreign aid funds.

The Buy American laws of the states are varied. New York requires state agencies to buy American steel. New Jersey requires that all state cars must be domestically produced. In addition, numerous states and municipal authorities require utilities, whether they are privately owned or publicly owned, to use American materials.

The Jones Act prohibits foreign ships from engaging in commerce between American ports. This law, of course, effectively bars all competition...
in U.S. domestic marine transport. The perverse effects of such laws are greater than might be expected. For example, at times Canadian lumber transported by Japanese flag vessels has undersold domestic timber from Oregon in the lucrative Southern California markets. In such cases, both the American merchant marine and the American timber industry suffer damage. Foreigners then become the unintended beneficiaries of these backfiring attempts to subsidize the American merchant marine.

Many of our statutes limit imports of agricultural products such as sugar, beef, dairy produce, and even mandarin oranges. Under the Meat Import Act, the President has authority to impose beef import quotas if imports of beef reach a certain trigger level. In practice, the U.S. generally has encouraged foreign exporters to restrain their sales voluntarily to avoid the imposition of formal quotas.

Our average tariff rates are low - scholarship requires me to state that they are as low as Japan's! Yet, the United States does levy high tariffs on selective items. Tariffs on textiles average 20 percent. Duties on fruit juices are over 27 percent, and the rate on ceramic products is over 14 percent. In addition, numerous nontariff barriers, often of a regulatory nature, are imposed by federal, state, county, and municipal governments.

Despite this nation's overall free trade posture, "protection" against imports into the United States now covers such basic industries as automobiles, steel and textiles. Pleas for further trade restrictions extend to such esoteric sectors as mushrooms, ceramic tableware, and even mechanics' shop towels. It is not a question of merely accepting the existing array of protection. The challenge is to deal with rising pressures for further restriction of world trade.

The Pressures for Protectionism

The first step is to understand why protectionism is popular. It is a means by which small, well-organized groups use the political process to their advantage. The benefits are received by the protected industries, while some costs are shifted to other companies that buy from the protected industries. Ultimately, most of the costs are borne by consumers in the form of higher prices. Thus, protectionism can be viewed as a hidden tax on the consumer. Like so many sales taxes, it is unfair. For example, a report from the Center for the Study of American Business showed that "voluntary" quotas on imports of footwear served as a regressive tax whereby low-income consumers were harder hit than high-income consumers. The Reagan Administration has eliminated these footwear quotas.

It is not a question of merely accepting the existing array of protection. The challenge is to deal with rising pressures for further restriction of world trade.

Positive Approaches to Trade Policy

Let me outline five positive approaches to these problems. First and most fundamental is carrying out domestic economic policies that expand production and incomes while holding down inflation. This, of course, is a plug for tax simplification, spending reduction, and regulatory relief. A healthy economy nips the protectionist sentiment in the bud.

Second is maintaining greater balance in macroeconomic policies. Our shift in 1981 to tight monetary policy and expansive fiscal policy contributed substantially to high interest rates and a rise in the value of the dollar. Smaller budget deficits will also help us to achieve smaller trade deficits. Meanwhile, if we are not careful, we will see an easy money policy - coupled with outsized budget deficits - lead to another inflationary spiral, which would further reduce the competitiveness of U.S. products in world markets.

Third is limiting any government "trade adjustment assistance" - which seems to be a politically necessary part of any comprehensive trade policy - to temporary aid in shifting labor and capital from industries hard hit by imports to more competitive activities. All too often, the government aid merely maintains an inefficient and uncompetitive industrial structure. That, in turn, adversely affects our competitiveness in world markets and generates further pressure for additional protectionist measures. The result is lower domestic employment, which, in turn, generates additional pressures for government interference. That is an example of a more general principle: government intervention begets more government intervention.

In a healthy and dynamic economy we must expect that some industries and regions will grow more rapidly than others and that some sectors will experience difficulty in maintaining their position and may even decline. We must rely primarily on market forces, and not on government bailouts, to make the appropriate adjustments. We only fool ourselves if we think that the solution to the real problems facing American industry is more government intervention - and that federal aid does not come with strings attached. Any business executive who still believes that government is his friend is too naive to be let out alone at night.

Fourth is acknowledging the positive role of multinational corporations in the world economy. Multinationals adapt to change more readily and are less likely to plead for protection than other companies. They also are the...
private-sector alternative to foreign aid and other types of government intervention. This, of course, explains why so-called transnational enterprises are not universally popular and are being attacked in international organizations.

Fifth is focusing on improving our own productivity. We cannot blame our poor production practices on foreigners. The answer is not to prop up industries via import restrictions or government subsidies—or to prevent them by law from closing down or “running away.” Rather, labor and management in each company need to face the challenge of greater productivity and enhanced competitiveness.

The current economic problems that face the U.S. and many other countries will not be solved by responding to the parochial concerns of individual industries and regions. Nor should international economic relations be dominated by short-term protectionist pressures from the producers of edible seaweeds, casein, and manhole covers—to name some recent candidates for protection. We will truly strengthen our foreign trade posture only as we improve our domestic productivity and competitiveness.

The Benefits of Free Trade

Some broader perspective on the current debate about free trade versus protectionism is useful. The case for free trade is rooted in a basic economic law: the principle of comparative advantage, which holds that total economic welfare will be enhanced if each nation specializes in the production of items that it can produce, in relative terms, most efficiently. This, of course, is an important case of Adam Smith’s more general point concerning the advantages of the specialization of labor.

Historical Experience

The arguments in favor of free trade are supported by a great deal of historical evidence. Through most of the twentieth century, the United States has played a strong leadership role in developing the world trading system. During the 1930s, however, the United States and many other countries followed “beggar-thy-neighbor” trade policies which contributed substantially to the worldwide depression. Unfortunately, as a people we have short institutional memories. Why, many of our students seem to think that Smoot-Hawley is a British rock group! But let us recall that it was the Smoot-Hawley protectionist tariff that epitomized the beggar-thy-neighbor approach in the United States. The results for many companies were extremely negative. Firms that had relied on substantial foreign business were limited to the domestic market, which for some was inadequate for survival. In any event, retaliation was counterproductive, a negative-sum game that harmed consumers in the United States and in other nations.

After World War II, this country embarked on a program of reciprocal trade agreements. Initially arranged bilaterally, they evolved into the effective multilateral trading system of the postwar years. This approach broke down many of the historical barriers to world trade. An especially fine example occurred in the 1960s: the acceleration in world trade and economic growth in that decade followed a sharp and mutual reduction in tariff barriers which contributed to lower prices for consumers. We continue today to reap benefits from the policies initiated in those years.

We can turn to our own economic history for earlier examples of the benefits of an open economy. This country began as a trading nation. If the concept of “Gross National Product” had existed in the 18th and 19th centuries, people would have pointed to the United States as one of the more open economies in the world, as measured by the share of GNP involved in foreign trade. I say that even though tariff debates were common throughout the 19th century. In its early years, the United States was among the more trade-oriented economies in the world. We were major suppliers of a wide variety of agricultural exports and raw materials, and of such delicacies as rum. In addition, our service exports, such as shipping, were an important economic activity. We were a major importer of manu-
factured goods and a major recipient of foreign capital. These factors continued to play a critical role in the development of the American economy during the 19th century.

Around the turn of the century the dynamics of the American economy shifted. Exports and imports became smaller shares of GNP and remained rather stable. U.S. investment abroad increased, gradually transforming us from an international debtor into a world creditor. Increasingly, we became a self-sufficient economy. Only in the last 20 years has the international sector once again begun to increase its relative importance in our economy.

Foreign trade is now an important element in U.S. business and employment. Exports and imports of goods and services each now represent over 12 percent of our Gross National Product. Twenty years ago, exports were less than 6 percent of GNP; imports, less than 5 percent. Much of this shift has occurred in the past decade, when imports and exports as a share of GNP doubled and a positive export balance has been maintained. Despite all the concern about a U.S. merchandise trade deficit, it is clear that this country generally runs a surplus when we consider both goods and services. In an economy that increasingly has been shifting toward a service orientation, any analysis of international economic activity that ignores the important service sector surely is inadequate. The growing exports of services has contributed to a net trade surplus for most of the last decade.

We should note that there is a close, but not generally appreciated, connection between imports and exports. A strong trade position requires both a high volume of imports and a high volume of exports. In fact, the only way, in the long run, to increase a country's exports is to increase its imports. U.S. exporters need to find foreign buyers with the dollars necessary to buy their goods and services. In general, these dollars are obtained when Americans import and pay for foreign goods and services.

In the short run, it is true that we can and do lend foreigners the dollars with which to buy our exports. When such loans are made at market rates of interest, trade is properly advanced. But when government-subsidized credit is provided, such funds are denied to other, more productive uses in the domestic economy.

Imports put dollars in the hands of foreigners—dollars which can then be used to buy our exports. When such loans are made at market rates of interest, trade is properly advanced. But when government-subsidized credit is provided, such funds are denied to other, more productive uses in the domestic economy.

In some cases, the connection between imports and exports is even more direct. Import restraints can reduce employment and profits in our more productive export industries, in many cases in the same region of the country. For example, in the non-rubber footwear industry, U.S. exports of hides to foreign shoe producers suffered as a result of our restraints on the import of foreign shoes.

The Advantages of Free Trade
Let us generalize from historical experience. The benefits of free trade are numerous:

1. Open trade contributes to lower prices by increasing the supply of goods and services competing for the consumer's dollar. Thus, the question of free trade is basically a consumer issue, and an extremely important one.
2. Open trade minimizes the role of government in influencing private-sector decisions. This allows individuals and business firms to respond to the needs and pressures of the international marketplace. Viewed in this light, free trade is key to promoting economic freedom and the private enterprise system.
3. Open trade improves the efficiency with which our own resources are allocated. Thus, we can see that free trade yields more growth, higher levels of employment, and an improved living standard here at home.

Aside from the direct and measurable aspects, trade stimulates competition, stirs creative activity, rewards individual initiative, and increases national productivity. Among nations, it speeds the exchange of new ideas and advanced technology. In the long run, international trade means the creation of new jobs and the reduction of inflation. In sum, free trade contributes to a healthier economy—one with more job opportunities and a wider variety of goods and services for consumers.

The Costs and Benefits of Protectionism
In this time of great interest in benefit/cost analysis, we may inquire as to what are the costs of free trade as well as the benefits. The obvious costs are those borne by the workers who become unemployed as a result of imports—assuming that imports are the cause. What is less apparent, however, is that any form of trade restraint to help a specific industry affected by imports really is an internal transfer of income and wealth to that industry from U.S. consumers. That transfer takes income and wealth away from American workers and owners of our export industries, who bear the brunt of retaliatory trade restrictions in the form of fewer jobs and lower profits.

Moreover, many of the benefits of protectionist measures, even to the group advocating them, turn out to be very temporary. For example, quotas on shoe imports resulted in an upgrading in the quality of imports. Thus, American producers found themselves threatened in that part of the market in which, prior to the protectionist action, they firmly dominated. The same process is taking place in the current case of "voluntary" restraints of Japanese auto imports.
One of the great difficulties in public policy discussions involving protectionist measures is the fact that the beneficiaries are usually few in number. Yet each has a large individual stake in the outcome. Moreover, those who benefit from protectionism have little concern about the likelihood of retaliation by foreign governments on other American industries. Thus, the incentive is strong for vigorous and concentrated political activity designed to erect special-interest trade barriers.

In addition, pleas for protectionism reflect the ability of relatively small but influential groups to convince legislatures to adopt policies that benefit them, albeit at the expense of citizens at large. The balance of power is extremely uneven, given the limited knowledge that consumers currently have about these matters. Those who benefit from exports and from the greater supply of goods and services are generally not even aware of the process by which they benefit. Although the benefits of open trade may far exceed the costs, those benefits—such as lower prices to consumers—are widely diffused among 50 states and 233 million residents. Any single consumer’s stake in the outcome is quite small. The individual consumer almost surely is not aware why the price of a given item is going down—or not rising. Consequently, resistance at the grass roots level to protectionist measures so often is considerably less than pressures for their adoption.

Nevertheless, if an economy is to reap the benefits of free international trade, it must also incur the costs. After all, trade changes the prices of individual commodities and, thus, forces reallocation of resources. Trade is truly a dynamic process. Over time, a nation engaged in trade experiences further changes in costs, technology, and tastes—all of which, in turn, alter the composition of its exports, imports, and domestic production. The adjustments do not occur instantaneously. And we must acknowledge that the benefits are not distributed evenly throughout the economy. Nevertheless, the consumer savings from freer trade exceed any sensible adjustment programs instituted for those who are initially hurt by the change.

Scholarly studies typically show that the total benefits of freer trade far exceed the costs. These gains from trade include savings to consumers, gains from moving resources out of inefficient sectors, stimulus to investment, and increased economies of scale.

Given the economic realities of the 1980s, international competition has become the most effective spur to greater domestic productivity. That painful but effective enhancement of the competitiveness of American enterprise is now the most important benefit from free trade.

Self-Inflicted Wounds to American Exports

The American public knows that many countries make it difficult for United States companies to export the goods and services that they produce. However, what is rarely appreciated is the fact that the United States government also places numerous obstacles in the way of our exports. Many domestic U.S. policy actions reduce the ability of American firms to compete both at home and abroad. Two prominent categories are U.S. regulations which impose burdens on domestic production not borne by foreign producers, and export controls, which restrict various types of exports on national security or foreign policy grounds or for domestic political reasons.

These obstacles to our own exports are self-inflicted wounds. Frankly, they tend to make us a laughing stock overseas when we urge other countries to lower their barriers to our exports while we make it more difficult for our exporters.

Domestic Regulatory Barriers to Exports

The United States conducts a great variety of domestic regulatory activities which inevitably increase the prices of U.S. goods and services. In some cases, foreign producers are not subject to similar burdens. In many other instances, the social objectives of other nations are achieved at lower cost.

There are important, special burdens that the federal government has imposed on companies involved in foreign trade. For example, the Foreign Corrupt Practices Act of 1977 requires strict record-keeping standards to monitor the anti-bribery sections of the statute. Violators of the Act face severe penalties. A company may be fined up to $1 million, while its officers who directly participate in violations or have reason to know of them face up to five years in prison and $10,000 in fines. Unfortunately, it is difficult to raise any discussion of the Foreign Corrupt Practices Act without being criticized for being callous on ethical matters. However, this statute has been cited for establishing a regulatory regime that displays the same cavalier attitude toward the burdens it imposes as do many other well-intentioned regulations. A former chairman of the Securities and Exchange Commission, the agency administering the Act, has stated, “the anxieties created by the Foreign Corrupt Practices Act—among men and women of utmost good faith—have been, in my experience, without equal.”

One of the major criticisms of the Act is that it has cost the American firms export opportunities without reducing the level of foreign corruption. By precluding American firms from taking part in questionable transactions, which may be perfectly legal and acceptable practices in many other nations, the Act reduces the ability of U.S. firms to compete overseas. The General Accounting Office has found in a survey of 250 American companies that 30 percent of the respondents that engaged in foreign business had
lost business as a result of the Foreign Corrupt Practices Act. The GAO has recommended that Congress amend the law to clarify several important provisions.

In addition to these highly publicized activities, several environmental programs impose requirements with regard to exports. For example, the regulations under the Federal Insecticide, Fungicide and Rodenticide Act require exporters to notify countries for which products are destined that a hazardous product is being exported 30 days in advance of the export—even if the product is not viewed as hazardous under the laws of the importing country. The importing nation must notify the exporter that the notice was received. No other country has such a restriction.

Export Controls

In many ways—and often without considering the effects—we have enacted laws and promulgated regulations that prohibit U.S. exports or make it more difficult for American companies to compete in foreign markets. For example, the Trans-Alaskan Pipeline Authorization Act prohibits the export of oil from North Slope fields. A provision added to an appropriations act for the Interior Department bans timber exports from federal lands west of the 100th meridian. When laws get that specific, you can detect the smell of special interest pressures.

In addition, the Export Administration Act provides for controls on exports of goods and technology to protect national security. That sounds fine. But, in practice, the law mandates controls over a great variety of products, including domestically produced crude oil, refined petroleum products, unprocessed red cedar, and, my favorite, horses exported by sea. In 1980 the Act was employed to embargo grain exports to the Soviet Union for national security reasons. It was invoked again in 1982 to carry out the ban against U.S. firms participating in the construction of the natural gas pipeline between the U.S.S.R. and Western Europe.

Export controls do more than limit U.S. international trade for the time they are imposed. These restrictions call into question the reliability of the United States as a supplier of products to other countries, which are likely to develop alternative sources. A clear example is soybeans—hardly a product that could be considered a strategic item. Although the purpose was to contain a short-term increase in domestic prices, the main effect of the U.S. embargo of soybean exports in 1974 was to induce Japan to turn to other producing countries, particularly Brazil. Japan proceeded to invest huge amounts in that country to develop alternatives to U.S. production, thus effectively and permanently reducing our share of the world soybean market.

Conclusion

Most export restrictions have been ineffective in meeting the foreign policy objectives that motivated them. Why do we keep them? Because they seem to be an inexpensive way of showing the public that the government is “doing something.” Keeping down U.S. exports may not show up in the budget of the State Department, but such action surely weakens the American economy.
Is the United Nations A Global Nanny?

International organizations such as the United Nations are expanding their efforts to regulate business. As an important example, take the U.N.'s draft Guidelines for Consumer Protection.

How could anyone possibly oppose guidelines designed to protect the consumer? It takes a hard heart to question the proposed United Nations' promulgation of such good things as product safety and purity, consumer education, and international cooperation. Yet, when you push aside the verbiage, you quickly find that the Draft Guidelines for Consumer Protection would flunk a truth-in-labeling test. Indeed, the so-called Guidelines have the makings of a blueprint for a more centrally directed society than now exists in any of the market-oriented economies in the world.

The Draft Guidelines for Consumer Protection contain seven objectives. Here is one sweeping goal:

To curb business practices at the national and international levels which adversely affect consumers (including abuses of a dominant position of market power by private and public enterprises).

Surely we all deplore business abuses, but how do we define business practices that "adversely affect consumers"? And who defines them? Nearly any product or business practice may be arbitrarily labeled "abusive" when it is held up against a standard that cannot be achieved or which consumers do not wish to pay for.

Other objectives in the Guidelines are equally troubling when we consider their far-reaching nature. Here is an example:

To promote just, equitable and sustainable economic and social development.

This is an imposing, high-minded ideal. But who is going to define what is "just" and "equitable" in any specific instance? Also, who is going to decide—and then control—what is "sustainable" development? And here is another "objective":

To establish standards of ethical conduct for those engaged in production and distribution of goods and services to consumers.

Certainly, ethical conduct is laudatory. But who will set the standards of "ethical conduct"? Who will place themselves above all others and regulate private behavior? How substantially would the interpretation of ethical conduct by a totalitarian differ from that of a free society?

The draft Guidelines also contain a set of general principles that governments are called upon to follow "to develop or strengthen their consumer protection policies." These principles are written as high-minded notions of "rights." The list is impressive and includes "physical safety from dangerous goods and services," "economic safety from offenses or malpractices [that deny benefits to consumers]," consumer information and education, and the right to form consumer groups and have their views represented in "the decision-making process."

At first blush, most of these principles or "rights" sound admirable. But even if a consensus could be reached on them, they do not materialize out of thin air. In each case, they imply a substantial expansion of the role of government.

Furthermore, nowhere do the Guidelines stipulate that there are costs attached to the array of benefits. For example, the achievement of greater physical safety involves added costs in producing or distributing a product.

The United States has learned the lesson that government-mandated safety standards raise the price of products—and, as a result, "price out" some of the most vulnerable consumers (e.g., those with low incomes) from the market for those products. Ironically, such "pricing out" leads to greater consumer risk. For example, requiring a safer but more expensive ladder than those now in common use would probably cause many people to climb on chairs and tables instead—a much riskier approach than using existing ladders.

As for the "right to consumer education," the U.N. Guidelines show the same high-handed attitude toward educational systems as they do toward economic systems. Consumers in less developed countries may, in fact, need a great deal of education with regard to products and services—but they may need basic educational skills, such as literacy, much more. As an educator, I am naturally suspicious whenever outside interests attempt to dictate the contents of a curriculum. The results are usually ineffectual utilization of scarce educational resources.

One general principle in the Guidelines raises very grave concerns:

the right to economic safety from offenses or malpractices which deny consumers optimum benefit within their economic resources.

Taken at face value, this is merely gibberish. But given the frequency with which people in Communist countries are thrown in jail for "economic offenses" against the state, this provision is potentially very dangerous. Is "Big Brother" to determine what are "offenses and malpractices" and the point at which consumers have derived "optimum benefit" from resources?

The one-sidedness of the Guidelines is indicated in the "right" of consumer organizations "to be consulted and to have their views represented in
"the decision-making process." The Guidelines make absolutely no provision for representing the views of the very businesses that are regulated. In fact, this U.N. document is not written from the viewpoint of free-market societies: it speaks of "the decision-making process," as though only one can exist. That is the give-away. These Guidelines are designed for a centralized, planned economy in which the national government makes the key economic decisions.

Here is another provision worthy of our attention:

**Government policies should seek to ensure that consumers obtain the maximum benefit from their economic resources.**

Does not this describe the United Nations as a global "nanny"? If I want to buy something silly for my wife's birthday, I could wind up violating a U.N. policy.

Here's another:

**Producers should ensure the availability of reliable after-sales service.**

This Guideline probably violates the antitrust laws. Why presume that service must be provided by the producer, unless a sale is a non-competitive, tie-in sale? Production and service are not necessarily provided best by the same source—at least this is true in competitive, open markets. Moreover, is this properly a concern of the United Nations? In the United States, we do not consider this an area for government regulation at all.

Another Guideline in the category of "protection of economic interests" casts the shadow of "Big Brother." One is the following:

**Governments should intensify their efforts to prevent economic offenses through systematically monitoring the adherence to the established laws and standards by producers, distributors and others involved in the provision of goods and services.**

It goes on to state that consumer groups "should be encouraged and supported in monitoring economic offenses." What sort of government systematically monitors the actions of private citizens? What sort of government encourages and supports specific private groups in the monitoring of other private groups, as though they were licensed vigilantes? It is obvious that the authors of the Guidelines have little interest in either economic freedom or personal liberty.

Finally, we see once again how the marketplace gets superseded in a section concerning food:

**Business practices affecting the processing and distribution of food products and especially the marketing of highly refined and expensive food products should be regulated in order to ensure that such practices do not conflict with consumers' interests or government aims in the area of food policy.**

Who is going to judge the so-called "conflict" between consumers' interests and business practices regarding the processing, distribution and marketing of food products? In free societies with market economies, if there is a "conflict," consumers protect their interests by not buying the product. Resorting to regulation simply projects "government aims" in food policy—and that is probably the true purpose of this provision. Moreover, why are "highly refined and expensive food products" singled out here? What all-wise power in a nation is going to determine that a specific category of food products presents a "conflict" with the interests of consumers, whereas another category does not?

International regulation of the production and distribution of goods and services via these Guidelines is a far cry from the central role of the United Nations, which is, according to the U.N. charter, "to maintain international peace and security." It is sad to see the U.N. diverting its attention to large-scale forms of economic regulation when it is doing such an inadequate job of carrying out the basic task for which it was established. Moreover, its charter explicitly prohibits the United Nations from intervening "in matters which are essentially within the domestic jurisdiction of any state." Much of the Consumer Protection Guidelines involves just such intervention.

In short, the proposed U.N. Guidelines on Consumer Protection would impose centralized control on the economies of sovereign nations. The United Nations should focus instead on its fundamental role of peace-keeper and not assume the role of global nanny.
III. Regulation of Business
The Future of Regulatory Reform

Actions on the regulatory reform front since January 1981 have simultaneously failed to meet the high hopes of regulatory reform enthusiasts and the fears of the defenders of the existing body of federal regulation. Those of us who are enthusiasts for regulatory reform must look back with disappointment at the modest changes, especially those regarding statutes, that have been made since January, 1981. It is fashionable, of course, to bemoan the lack of leadership on this score in either the Executive or Legislative Branches. Although I am not inclined to let either end of Pennsylvania Avenue off the hook, the basic problem is much deeper. It is the fact that the necessary foundation has not been laid in terms of public understanding and support for reducing the burdens of regulation.

To be sure, the media are generally unhelpful, or at least extremely naive on that score. Just try to change a comma in the Clean Air Act, and you lay yourself open to charges that you want to “gut” environmental protection, that you are a green-eyeshade type who does not care about ecology. Perhaps some modern-day Shakespeare can write the script whereby a reform-minded economist convincingly declares, “If I am polluted, do I not cough?”

The sad fact is that public opinion polls show uncritical—and growing—support for the position of “environment über alles.” For example, an April 1983 poll reported that 58 percent agreed with the following statement: “Protecting the environment is so important that requirements and standards cannot be too high and continuing environmental improvements must be made regardless of cost.”

It is also useful to observe the results of a survey examining who people trust to recommend regulatory changes. In the case of the Clean Air Act, “environmental groups” received a positive 74 percent and university professors 72 percent. “Business and industry” was last, with 39 percent, just below the “news media” with 47 percent. Perhaps those of us in academia have been a bit too shy and have left the field of battle to the “true believers.”

Today’s regulatory system is far from the idyllic state in which it will consist solely of rulings that generate more benefits than costs—but neither is it about to wither away. The similarities between the regulatory system of mid-1983 and that of January 1981 are far greater than the differences. Yet, when we listen to the spokesmen of the counterattack against regulatory reform, we hear a different viewpoint. Let the opponents of regulatory reform speak for themselves so we can judge the proportions of analysis and emotion. Here is an excerpt of a recent article by Michael Pertschuk, former chairman and now member of the Federal Trade Commission:
A goodly number of Mr. Reagan's regulators have now spent two years dismantling the very regulations that in prior incarnations as corporate lawyers and lobbyists they had opposed... Their deregulatory plans are fueled by an admixture of free-market ideology and corporate sycophancy. Consumers are merely bugs on the windshield.

Because Mr. Pertschuk and so many of his allies are attorneys, I am reminded of the old legal maxim: "if the law is against you, argue the facts; if the facts are against you, argue the law; if they are both against you, bang on the table."

This surely is not the time to rest on laurels. Only a fraction of the regulatory reforms envisioned in the beginning of 1981 have been accomplished. Most of the progress has been made in the form of administrative changes, especially those establishing a comprehensive system for reviewing pending rulemaking.

William Ruckelshaus, the new administrator of the Environmental Protection Agency, has sounded a cautionary note. He contends that the current climate in Congress is not appropriate for considering changes in environmental legislation. Ruckelshaus' statement, as well as recent events at EPA, underscore the vital role of selecting appointees to regulatory agencies. The experiences of recent years in several administrations demonstrate the need to select people who take a balanced approach to the benefits and burdens of regulation. Appointing uncritical enthusiasts for expansion of government regulation inevitably produces a regulatory regime characterized by excessive burdens and cavalier disregard for economic impacts. Similarly, regulators who lack a basic sympathy toward the programs they administer are counterproductive. They can set back the prospects for regulatory reform very substantially.

Regulatory activities deemed worthy of continuation should be managed by people who are both sympathetic to the important social objectives to be achieved and equally concerned with minimizing the burdens. The leadership of regulatory agencies must understand that good policymaking means a careful balancing of a variety of important considerations—such as clean air and high employment, healthier working conditions and greater productivity.

Under the circumstances, it is sad to read of the boasting of a group of ex-regulators in the Carter Administration that they will use networks of civil servants at their former agencies to oppose the Reagan Administration's regulatory relief efforts. "These people will tip off the

The similarities between the regulatory system of mid-1983 and that of January 1981 are far greater than the differences.

Perhaps the most urgent need is to convince members of Congress to demonstrate a sense of balance when they write the basic regulatory laws. The task of updating regulatory statutes is not easy. The types of changes that should be made depend on the nature of existing regulation, the specific regulatory mechanisms currently in use, and the shortcomings, if any, in the unregulated private economy. A simple or uniform response is not appropriate. Each regulatory law should be examined individually and carefully, and—despite the counterattacks by the advocates of further government intervention—dispassionately.
Expropriation Rears Its Ugly Head

The stability and fairness of our political institutions are a unique hallmark of the United States. In fact, one of the basic arguments we often employ to attract investment from overseas is the knowledge that the threat of expropriation does not face private enterprises in the United States the way it does in many nations overseas.

Unfortunately, such is not always the case. For example, local government in Oregon is attempting what is literally a power grab. Using an obscure law (the Federal Water Power Act of 1930), public utility districts in that state are trying to take over a private dam used for the production of electricity via hydropower. The Merwin Dam was built by the Pacific Power and Light Company more than half a century ago. That investor-owned utility has been operating and maintaining it ever since.

Government-owned utilities in many parts of the Pacific Northwest have gained a dominant position. Now they are trying to use the procedures of federal energy regulation to require the sale of the Merwin Dam to them at bargain basement or, more accurately, forced sale prices.

Back in the early 1930s, the Pacific Power and Light Company spent $20 million to build the dam. Given the tremendous amount of inflation since then, the current value is in the neighborhood of ten times that amount. But earlier this year, an administrative law judge of the Federal Energy Regulatory Commission ruled against the company. He is urging the Commission to force Pacific Power and Light to sell the dam and its 135,000-kilowatt capacity generators to public power agencies for $10 million—which is the depreciated book value.

Using the book (historical basis) depreciated value instead of the current market value is a facade for confiscation. That arbitrary action has all the earmarks of the foreign takeovers of American business that we so properly decry. The company is appealing the ruling to the full membership of the Federal Energy Regulatory Commission.

Because Merwin Dam provides only 4 percent of Pacific Power and Light's power supplies, this episode might be described as the proverbial tempest in a teapot. But there are many other privately built and operated hydropower facilities in the Pacific Northwest that could come under a similar attack should the current government position prevail. We forget that many small private utilities in recent years have been taken over by government-owned utilities because of the array of federal statutes which discriminate against private enterprise.

For example, when the Environmental Protection Agency established sewage standards several years ago, that forced privately owned sewer companies to sell out to government agencies. That action occurred because, under the federal statute, EPA could give the government-owned agency a generous grant to cover the cost of meeting its standards, but it could not give tax-paying business enterprises a nickel.

We delude ourselves if we believe that government-owned utilities are a bargain. The prices they charge may be lower, but much of their costs are passed on to the taxpayer and consumer in other forms. Because they are exempt from taxes, the rest of us have to pay more—or see those budget deficits rise even further. Because the interest on their bonds is tax-exempt—and hence their securities have especially attractive after-tax yields—private companies have to pay higher interest rates in order to sell their bonds.

Public takeovers of private enterprise beget more government intervention. The less efficient the government undertakings, the higher the government has to raise taxes in order to subsidize them. The heavier the tax burden on private businesses, the fewer funds they have available to finance expansion. The result is increased pressure for bigger government.

The moral of the tale is clear. We must constantly guard against those well-meaning proposals that fail to take account of the full costs they impose on the private enterprise system and, thus, on the American consumer.
Five Ways to Improve U.S. Energy Policy

Over the years, an inconsistent blend of regulatory and tax policies has made it more difficult and costly to achieve the nation's energy objectives. There are fundamental problems of consistency in relating the long-term goal of increasing domestic energy supplies and the workings of regulatory and tax policies.

For example, for many years depletion allowances encouraged domestic production while "prorationing" restricted the actual amounts that could be produced. Price controls on natural gas encouraged consumption of energy, while import restrictions curtailed the supply of energy. Yet, earlier periods of American history showed that—without either government subsidy or controls—the private sector could and did readily adjust to changes in the availability of and demand for energy.

When we examine the pre-regulatory period, we find that successive shifts occurred from one energy source to another, as the underlying economics—relative prices—changed. The changes were comparatively quick and easy. In 1800, for example, illumination was provided mainly by candles and oil lamps, with fuel for the lamps coming from whale oil. Yet, whales did not become extinct as the country grew. As the price of whale oil rose, consumers simply switched to substitutes. In the 1850s, coal oil or kerosene dominated the residential market for illumination. Its success was followed by an equally meteoric decline in favor of a new fuel that had appeared in the market, petroleum.

The shifts from whale oil to kerosene to gasoline resulted not from an act of Congress or a subsidy from the Treasury, but from successive movements in the price of energy. The implication is clear: the sooner that government frees all energy sources, such as natural gas, from artificial price restraints, the sooner will new domestic energy sources become commercially competitive. Conversely, the continuation of price controls on natural gas delays the time when new domestic sources, including solar energy or synthetic fuels, will come into widespread use. The major spur to developing domestic energy sources is not government subsidy, but price decontrol of existing energy sources.

The clash between economic efficiency and government regulation is currently most visible in the area of natural gas. The Natural Gas Policy Act of 1978 was designed to raise the wellhead prices of natural gas in order to help achieve a balance between supply and demand. But the numerous price disparities among different categories of gas prompted new inefficiencies. The smooth transition to a deregulated market envisioned by the framers of the Act will not occur under the existing statute.

High-priced natural gas is being imported from Canada at a time when cheaper U.S. supplies are in surplus. The problems in the gas market have been caused by the interaction of inflexible federal price control and rigid contracts between pipeline companies and producers. The contracts, in turn, were by-products of the long and convoluted history of government regulation of energy.

The basic problem is that federal regulation is too rigid to allow gas prices to reflect changing conditions. Natural gas prices are now at levels that have encouraged switching back to oil. With an estimated 15 percent of capacity idle, it is not clear that a sharp run up in prices would result if natural gas were deregulated. The successful decontrol of oil prices in 1981 provides the appropriate model.

The Future Role of Regulatory Policy

There is another way in which regulation hinders domestic energy production. Environmental and other regulations create major obstacles facing virtually every proposed energy project—including those that are finally approved. One of the most serious energy problems in the United States today is the long delays that occur during the planning and construction phases of new energy projects—even those that successfully surmount all of the regulatory obstacles. From the investor's viewpoint, those problems increase uncertainty—which can be devastating for major capital projects such as those involved in developing new forms of energy. Let us recall that it took a special act of Congress to override legal and ecological barriers so that the Alaskan pipeline could proceed.

A realistic and effective government policy for the energy sector of the economy requires changes in the federal tax and regulatory systems

Nevertheless, public concern about pollution of air and water and destruction of natural resources continues to be great. The need, thus, is for a careful review of the vast and cumbersome regulatory labyrinth. The purpose should be to achieve a more cost-effective regulatory regime by eliminating or revising the numerous regulations that do not pass the economic test of generating more benefits than costs.

Recommendations

From the viewpoint of better meeting the needs of American consumers, a realistic and effective government policy for the energy sector of the economy requires changes in the federal tax and regulatory systems. These changes fall into two categories: (1) eliminating the special benefits that have been granted to the various segments of the energy industry, and (2) simultaneously removing the many obstacles that have been placed in the industry's path. Here is a brief outline of the needed changes:

(1) Eliminate the windfall profits tax. That tax does nothing to help
curtail energy consumption, but it simultaneously reduces the financial ability of the private sector to increase domestic energy production.

2. Eliminate the regulatory functions of the Department of Energy. The sooner that domestic energy prices equal world market prices, the sooner will new domestic energy sources—conventional and unconventional, including synthetic fuel, solar energy, geothermal etc.—become competitive. Moreover, realistic prices are the most effective stimulus to energy conservation. Deregulation of natural gas prices is long overdue.

3. Eliminate the host of tax breaks for specialized energy projects. Tax subsidies would no longer be needed in an environment where realistic energy prices prevail. The experience of the home insulation industry is instructive. The producers in that industry found that their order books became full when the public realized that insulation is a good way of reducing high and rising energy costs. The federal subsidies actually came later.

4. Cut back the regulatory obstacles which impede the construction and operation of new energy projects. What is truly needed is a comprehensive reform of the regulatory process. Without these reforms, many of the tax incentives for new investment will be ineffective. The inability to obtain the many government permits needed for a new project cannot be overcome by increasing the after-tax rate of return.

5. Cut back the expenditure subsidies for the highly specific energy activities that the Congress arbitrarily has chosen to support. These special aids would no longer be necessary if the first four proposals are adopted. The elimination of the windfall profits tax revenues would make it more urgent to reduce these low-priority outlays in order to minimize budget deficits.

Boiled down to its essence, the most effective regulatory policy to promote domestic energy development and production is to achieve a well-functioning market economy that does not require special policies for any specific industry—energy or any other. In an analogous manner, the optimum tax policy is to treat the activities of the energy industry exactly the same way as any other business—without prejudice or favoritism.

IV. Economic Change in the 1980s
In Change There Is Opportunity

"Forth into the future's dawning glow" is what the poet tells us. The economist, in contrast, traditionally is the wet blanket. Realistically, the future is not likely to be glowing. But there will be a future in which each industry, company, and individual will have an opportunity to succeed or to fail.

What kind of future does American business face in the coming decade? The shortest response on record would be simply to say, "We don't know." But this professor does not use short answer tests, even for himself. Like many students trying to answer a difficult essay question, let us reconnoiter around the question before we respond. To begin with, life is full of surprises. Looking back over the past three decades, who had any idea that we would see the United States in two major wars, or that inflation and unemployment would ever again reach double digits, or that hard rock would become something you listen to rather than try to pulverize? On the latter score, sometimes I am tempted to revert.

Traditionally, we have associated growth with opportunity. A rapidly expanding national economy, almost by definition, generates a great array of new markets, new products, and new jobs. That surely was true for much of the past. But, more recently, when the growth rate of the economy dropped, the expectations of most of us declined. The outlook of many turned sour because, supposedly, opportunity was also declining.

But perhaps the economist does not have to be totally the wet blanket after all. Even in a bad year, our private enterprise system generates far more jobs and income per capita than other economic systems do in their best years. After all, the acid test of the strength, durability, and attractiveness of a private enterprise economy occurs when the borders between a capitalist and a communist nation are opened. We can predict with unfailing accuracy the direction in which people will voluntarily move. Whatever their limitations, capitalistic societies win overwhelmingly when people vote with their feet.

But there are more specific reasons for sounding an upbeat note. We have learned that change also brings opportunity. And the continued advances in technology surely indicate that the pace of change will not slacken. There is a renewal in our society of faith in science and technology. The 1980s will see the introduction of more changes resulting from new technology than the 1970s—changes in basic office and factory work procedures and further shifts from standard products to more sophisticated items such as word processors and robots, which are hybrids of goods and services.

To succeed in times of change, rather than in periods of rapid growth, is more of a challenge. Not every industry, and surely not every company
or individual, necessarily comes out a winner. But it is a far more
dynamic situation than the broad set of numbers show at first blush.
After all, in every year—good, bad, or indifferent—someone is starting a
company or launching a product or hatching an idea that will grow and

To succeed in times of change, rather than in periods
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prosper. At the time, we are not able to forecast the specific winners or
losers. But with the benefit of hindsight, we know that there will be some
of each. Similarly, we are not a static society. The boom towns of the
1960s and 1970s were in different locations than the likely growth areas
of the 1980s. But the same may undoubtedly be true for the places that
decided in the '60s and '70s, as well as those that will fizzle in the '80s.

Let us focus on four types of changes that will vitally affect business
opportunities in the decade of the 1980s and beyond. We need to
acknowledge that many of those who respond to the changes may indeed
see them as opportunities. Yet, others, especially those who merely react
passively, will find them more in the nature of threats.

Economic and Social Changes
First of all, we are already seeing a shift in emphasis from traditional
smokestack industries to service and manufacturing companies whose
products have a much higher content of knowledge, information, and
technical skill. But it is important to keep that change in perspective.
Clearly, there is genuine reason for concern about the future in regions
of high unemployment and declining sales. But U.S. manufacturing com-
panies are not about to collapse. Indeed, those firms that succeed in
enhancing their productivity and controlling their costs will prosper.

Let us turn to the second important shift, which is geographic. In-
creasingly, people are finding that the quality of life often diminishes in the
largest metropolitan areas, and that small towns still lack the amenities
and diversity of activity that many people have come to expect. Medium-
size cities now have the most favorable growth prospects for the years
ahead. That is where many people want to live, and where companies are
setting up new factories, branch stores, and regional offices. The in-
dustrial growth is occurring in cities large enough to provide a good
range of amenities to their citizens, but small enough so that the indi-
vidual does not feel overwhelmed.

This geographic shift is also taking place in good measure because of a
related but undramatic, long-term trend occurring in the American
economy. It is the adjustment to a lower level of inflation. This is a
positive—but not a painless—process. Costs are often lower in the
medium-sized cities. There is also a new sense of realism in business deci-
sion making today. Companies are becoming more cost-conscious.
Poorly justified company investments and lax expense commitments are
no longer automatically bailed out by inflation. Managements are learn-
ing once again the advantages of being competitive in an economy in
which the federal government does not automatically come to help out
every loser in the marketplace.

Similarly, employees are learning that their wages, salaries and fringe
benefits are vitally dependent on the future success of their company.
Workers are increasingly—though perhaps not enthusiastically—willing
to accept changes in contracts, workrules, and job practices necessary to
ensure their company's future. Consumers are learning the hard way that
purchases of art and coins and postage stamps are once again judged as
consumption activities, rather than easy investments in what had been a
continually rising price level.

But this new sense of realism is very recent. It could easily be reversed
if the federal government decides to bail out various declining industries.

A third important shift in the years ahead is the renewed emphasis on
the private sector of the economy. People are once again advocating a
reduced role for government as an agent of social change. Not that the
state will wither away. But, certainly for the next several years, we can
expect that the private sector will be growing faster than the public sec-
tor. In part, that is a reaction to the rapid expansion in government ac-
tivities that we have witnessed in recent decades—an expansion that often
has created more problems than it has cured. That shift reflects the
rediscovery that the private enterprise system, despite its various short-
comings, is still the primary engine of progress in our society and the key
generator of income and wealth.

The fourth and final shift is a growth in our communal perspective,
from essentially domestic-national concerns to worldwide-multinational
dimensions. Surely, we cannot anticipate any movement to world govern-
ment. That would run counter to the prevailing trend of decentralization

We are increasingly abandoning the notion that if anything
goes wrong in an individual's life experience, the blame
should be borne by society as a whole

of governmental power in modern societies. What comes to mind are
such obvious but undramatic changes as the doubling in the proportion
of our national production that is exported—as well as a doubling in the
proportion of our national income that is spent on imports.

Then, of course, we have experienced quite a few dramatic instances of
the powerful impact of foreign developments on our domestic society.
Two related cases are the OPEC oil embargo in 1973-74 and the Iranian
Revolution in 1979, both of which had immediate and costly impacts on
our economy as well as on our personal lifestyles.

In addition, many industries are feeling the effects of foreign competition. The traditional response too often is to complain to the government and ask it to restrict imports. The more satisfactory approach, of course, is to examine ourselves and see how we can do better. After all, we cannot blame our poor production practices on foreigners. A very considerable pace of change can be expected in the years ahead, as well as no shortage of problems in our society. The changes surely will provide growing opportunities for those who try to take advantage of them.

Opportunity, Risk—and Work

Along with the opportunity that change brings, however, there is also greater uncertainty. With greater opportunity there goes, of course, more risk. And that, too, is another area of change that is becoming visible. As a nation, we are increasingly abandoning the notion that, if anything goes wrong in an individual's life experience, the blame should be borne by "them," by society as a whole. We are coming to realize that if it is our skills and efforts that should be rewarded when things go well—then that also implies the reverse. It is our individual responsibility when things do not work out as well as we expected them to. Thus, greater opportunity also implies more individual responsibility.

Finally, it has been my observation over many years that one factor is often the determining variable. It is the original four-letter word—WORK. The degree of sustained industriousness, the ability to work hard even in the face of unexpected disappointments, is often the most important long-run factor influencing who will succeed greatly or who will just make it—or who will fail.

The Economic Challenges of the 1980s

The odds favor a future period of sustained economic growth, accompanied by moderate inflation. But this happy turn of events is not written in the stars. Surely, the political process is not going to keep economic policy on automatic pilot for any length of time. Moreover, inflation may well accelerate again and the nation's growth rate may sputter. Yet a healthier economy will be more likely if, as a nation, we make three types of difficult decisions:

1. Labor and management in each industry must deal with the competitive problems that face them, rather than seek government assistance. Although discussions of economic policy inevitably are drawn to public-sector actions, we need to be reminded that ours is a private enterprise system in which most economic decisions are made in the private sector. After all, so many of the difficulties facing our key smokestack industries are due to decisions by the companies and the unions in those industries. Management and unions together have pushed their labor costs far beyond other American manufacturing industries, and, until recently, the industries have emphasized high unit profit but stagnant rather than growing market areas. Many industries have also been slow in adopting new technology.

Moreover, it is intriguing to examine the few cases where management is about to close a low-or no-profit factory—and the employees purchase it. Then the new owners proceed to make the difficult decisions—to slim down manager and worker ranks, eliminate unproductive work practices, and so forth. Ironically, if labor and management had agreed to that course of action earlier, in many cases the factory would not have been closed down in the first place.

The easy answer to today's difficulties—which often unites management and labor—is to go to Washington for credit or import restraints or other subsidies. This special treatment, of course, comes at the expense of consumers and taxpayers. It should be opposed primarily because it provides the wrong signals for future economic behavior.

2. Government decision makers must face up to the fact that the 1981 tax cuts have not been matched by expenditure reductions. In a real sense, those tax cuts have not yet been earned. They can be earned, however, by reducing the rapid growth of federal outlays. Three major areas of the budget are promising candidates for further pruning. We all know about entitlements and defense. But it does not require exhaustive research to reveal a third part of the budget: "all other." Not all the items in that part of the budget are social programs, nor have they been cut to the bone. Generously funded programs such as subsidies to dairy, tobacco, and sugar producers and to shipbuilders and ship operators are good—or bad—examples. These and many other special benefits to
specific segments of society are in the budget simply because of the political muscle of the special-interest groups supporting them.

Given the outlook for substantial deficit spending, more of those sacred cows in the federal budget should be taken out of the feedlot and led to slaughter. Our economic prospects would be a lot brighter if the deficits were half their current size. The sensible solution is not to raise taxes. Rather, it is to cut spending comprehensively in each of the three categories.

3. Finally, to face the real economic problems in our country today, we must focus more on our own shortcomings rather than take the easy, and low, road of blaming our economic difficulties on “foreign devils.” We should begin by acknowledging the obstacles that we have put in the way of our own exports. Our “holier than thou” attitude toward protectionism offends our trading partners who are well aware of our many obstacles to their exports—as well as our wounds that have been self-inflicted through federal restrictions on our own exports (often for foreign policy purposes). At a time when reciprocity has become a new buzzword in foreign trade policy, perhaps we can reduce some of the barriers to our own exports and then “reciprocate” by reducing some of our import barriers.

Conclusion

My final point is to stress the importance of time as a key variable in economic decision making. For example, the panaceas tend to be popular because the benefits come early and the costs later. An easy money policy is a good example. Conversely, the tough but effective approaches, such as monetary restraint to curb escalating inflation, generate their costs before their benefits.

An important characteristic of good management is to make tough decisions promptly.

Yet, those hard choices become even more difficult the longer we wait. The longer that the tough decisions are postponed, the more imbedded “entitlements” arise in the workplace, and the greater number of trade obstacles are in place, and so on. And time can be crucial in a budget restraint effort. After all, the most uneconomical project may begin to develop a serious economic justification after substantial outlays are made on it. The argument for completing it becomes compelling: What is the value of half a bridge, or half a breeder reactor, or half a nuclear carrier?

Thus, an important characteristic of good management, whether in the private or the public sector, is to make tough decisions promptly. Most people can make those decisions in a time of crisis. The challenge is to

act so as to avoid the need to press the panic button.

Let me conclude with this note. Please remember during the difficult periods ahead that, of all the bumper stickers and marching slogans one might use, the most appropriate sign is the one that proclaims, “The end of the world has been postponed.”