

# MANHATTAN REPORT

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## In Defense of Supply-Side Economics

by Bruce Bartlett

There has been much written in the press about supply-side economics since the Reagan Administration made it the basis for its economic program. Predictably, the Left has been virulent in its opposition to supply-side policies, such as a radical reduction in tax rates, government spending and regulation. However, curiously, there has also been growing criticism of supply-side economics from the Right, from economists associated with the so-called Austrian school. Now that the political fight is behind us, it is time for a sober analysis of this Austrian criticism.

In recent months supply-side economics has come under attack from Professor Hans Sennholz of Grove City College (*Review of the News*), Robert Anderson of the Foundation for Economic Education (*The Freeman*), Richard Ebeling (*Libertarian Forum*), and Tyler Cowen (*Policy Report* and *Libertarian Review*). This "Austrian" criticism appears to boil down to three crucial points. An examination of these points will show, I believe, that in each case the critic either misunderstands what supply-side economics is all about, or he is simply wrong.

1. *Supply-side economics (i.e., the Laffer Curve) seeks to cut tax rates so that government revenue can be increased.*

In the first place, the Laffer Curve is merely an analytical device which demonstrates that tax rates can be too high in an economic sense. It was never meant to imply that an across-the-board tax rate reduction would pay for itself immediately in increased revenue. For this to be the case, one would obviously have to know where, precisely, one is on the Laffer Curve.

It is unlikely that the nation as a whole is on the upper end of the Laffer Curve. Nevertheless, particular taxes can be too high from a revenue point of view. The capital gains tax is a classic example. When the capital gains tax cut was first proposed in 1978, the Treasury Department esti-

imated that it would lose billions of dollars in revenue. In fact, the most recent evidence suggests that the capital gains tax cut clearly increased capital gains tax revenue above what it was estimated to be without a cut.

This, however, is precisely the point which disturbs the critics. They regard any increase in tax revenue as equivalent to an increase in tax rates. They oppose as immoral any action which would increase government revenue. As Tyler Cowen put it, "the most serious drawback with the Laffer Curve is that it may be used for the purpose of maximizing government revenue."

Clearly, this argument is nonsensical. By this line of reasoning, the cut in capital gains tax rates should have been opposed on libertarian grounds! It would seem, moreover, that the only tax cut acceptable to the Austrians would be one whose sole purpose was to lose revenue for the government and which would have no incentive effects whatsoever. Presumably, therefore, Jimmy Carter's idea of giving every person in America a \$50 rebate, as he proposed in 1977, would be the perfect libertarian tax cut. It is also hard to see on what grounds such libertarians would oppose a tax system which taxed all income at the rate of 100 percent. Since government revenue would be zero, I would suppose that this system would be considered acceptable, based on the logic which has been presented.

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## Inside:

- An exclusive interview with economist-turned-congressman Philip Gramm.
- A new study from agricultural economist Bruce L. Gardner provides an objective breakdown of the actual costs of our farm support programs.
- A group of economists based in the Rocky Mountain region of Montana think they have answers to some of the country's most pressing environmental problems.

Mr. Bartlett is Deputy Director of the Joint Economic Committee of the United States Congress and the author of the critically acclaimed *Reaganomics: Supply-Side Economics in Action* (Arlington House).

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# Bartlett's Defense

(Continued from front page)

2. *Supply-side economics is just the obverse of Keynesianism, substituting government manipulation of aggregate supply for manipulation of aggregate demand.*

This criticism is simply wrong-headed and shows that the critic has confused supply-side economics for reindustrialization, which is something entirely different. I have spelled out the differences at length in *National Review* (May 15, 1981), so I will just summarize them here:

Supply-side economics does not seek to use government to direct investment from here to there or even to establish some target for overall investment in the economy. Supply-siders simply say that for 40 years we have ignored the supply side of the economy — i.e., saving, investment, productivity, capital formation, work incentive, etc. — and concentrated solely on maintaining aggregate demand through easy money and budget deficits. Supply-siders do not want supply to supplant demand or ignore it, merely to reestablish parity between supply and demand.

Supply-siders have no wish to manipulate the tax system in order to encourage production. They feel that by moving toward tax neutrality, wherein the tax system favors neither consumption nor production, that this will be sufficient. The many gimmicks and sweeteners loaded on to the recent tax bill were not put there by supply-siders. They favored the original Reagan plan, which simply cut marginal tax rates across the board.

The confusion developed when liberals like Professor Amitai Etzioni of George Washington University began talking in similar rhetoric about declining productivity, capital investment, and saving in the United States, calling for "reindustrialization." However, the legislative proposal from those who talk about reindustrialization, rather than supply-side economics, have been in the nature of targeted tax credits to business, reestablishment of the Reconstruction

Finance Corporation, and the like. Such notions are totally contrary to the basic idea of supply-side economics and are justifiably criticized as being the first step on the road to centralized economic planning.

3. *Tax cuts without corresponding spending cuts merely shift the burden of government finance and, insofar as the deficit is increased, are inflationary.*

There is a grain of truth in this argument, since government spending is clearly a better measure of the burden of government than taxation. However, there are several fallacies which entrap those who make this point.

First, the burden of taxation is in fact much greater than just the aggregate amount of dollars collected. There is also an opportunity cost which the economy bears in the form of lost production which would have occurred had tax rates been lower, even though the same amount of revenue was raised. As Paul Craig Roberts, Assistant Secretary of the Treasury for Economic Policy, put it:

The total resources claimed by government is a better measure of the tax burden than tax revenues alone. But some economists let this adding up of concrete resources blind them to another measure of the real tax burden — *the production that is lost to disincentives*. It is difficult to see the production that doesn't take place because the government made it unprofitable, but it is nevertheless a part of the tax burden.

From the viewpoint of this more complete measure of the tax burden, a tax cut can be real even if it is not matched dollar for dollar with a spending cut. That's because a reduction in marginal tax rates changes relative prices. It causes people to shift into work out of leisure and into investment out of current consumption. These shifts occur even if people expect that in the future taxes might be raised to pay off any government tax base; to make good on the deficit future tax rates would not have to be raised as much as they were cut — if they need to be raised at all.

The particularly interesting thing about Roberts's argument is that the concept of oppor-

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*The concept of opportunity cost is a uniquely Austrian concept. Why modern day Austrians should fail to see this is inexplicable.*

tunity cost which he uses is a uniquely Austrian concept, having been especially well developed by F.A. Hayek. Why modern day Austrians should fail to see this is inexplicable to me.

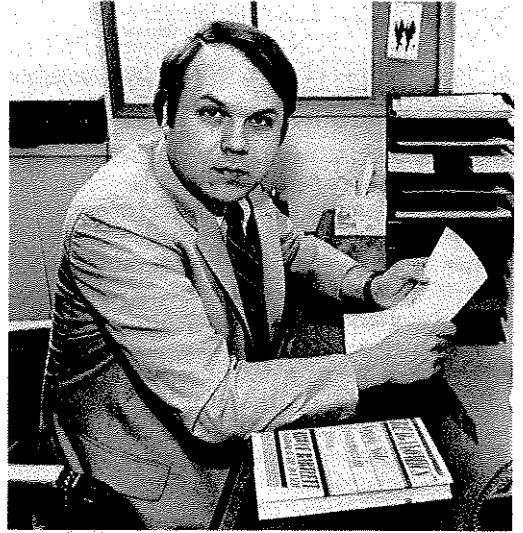
Secondly, there is nothing inherently inflationary about budget deficits and, in any case, there is a big difference between a deficit resulting from a cut in tax rates and one resulting from increased spending. One must distinguish between the two.

All budget deficits do is replace government tax revenue with government borrowing. There is nothing inflationary about that. Inflation only occurs when the Federal Reserve "monetizes" the debt by buying government bonds with fiat money. It does so in a vain effort to keep interest rates from rising in response to an increase in the deficit. By pouring newly created money into financial markets, the Fed used to be able to fool people into believing that saving had actually been increased, which caused interest rates to drop. But now people know that increases in the quantity of money today become higher prices next year, so financial markets discount increases in the money supply immediately by adding an inflation premium to interest rates. Today, therefore, any action by the Fed to monetize the debt would be self-defeating.

Moreover, it should be kept in mind that the Fed is not confined to monetizing only government debt. It would be just as inflationary for the Fed to monetize private debt, and it could do this even if the Federal Government were running a budget surplus!

Finally, I will just repeat an argument I have made elsewhere with respect to the political consequences of focusing exclusively on the deficit. The problem is that deficits can be reduced either by reducing spending or by increasing taxes. People who concentrate too heavily on the deficit inevitably find themselves trapped into supporting higher taxes. Since taxes increase automatically during times of inflation — as people get pushed into higher tax brackets — if one merely opposes a tax cut, it is the same as supporting a tax increase. Those who say we should postpone a tax cut until the budget is balanced are really saying we should increase taxes to balance the budget. As Milton Friedman has pointed out, this phenomenon has frequently made conservatives the unwitting handmaidens of the big spenders:

There is an important point that needs to be stressed to those who regard themselves as fiscal conservatives. By concentrating on the wrong thing, the deficit, instead of the right thing, total government spending, fiscal conservatives have been the unwitting handmaidens of the big spend-



**Bruce Bartlett**, author of *Reaganomics: Supply-Side Economics in Action*

ers. The fiscal conservatives scratch their heads and say, "My God, that's terrible; we have got to do something about the deficit." So they cooperate with the big spenders in getting taxes imposed. As soon as the new taxes are imposed and passed, the big spenders are off again, and then there is another burst in government spending and another deficit. . . . I would far rather have total spending at \$200 billion with a deficit of \$100 billion than a balanced budget at \$500 billion.

There are many other points which have been raised by the right-wing critics of supply-side economics, but most of them apply either to specific statements by specific authors or to some action by the Reagan Administration which has nothing to do with supply-side economics as such. The three criticisms I have discussed seem to be the main ones leveled against supply-side economics by each of the critics. I think they have all been shown to be baseless and politically naive.

It is certainly true that in a perfect world it would be better to cut both taxes and spending, it would be better not to have deficits at all, and it would be better not to justify tax cuts on the Laffer Curve. But we don't live in a perfect world. We live in a political world, and we have to concern ourselves not only with goals but with the political means for achieving those goals. The reality is that cutting back the size of government is a tough job. Conservatives have tried to hack away at it for 40 years, and the only blood left on the floor was theirs. It was only when the supply-siders came along, saying it is just as good to reduce the relative size of government by stimulating growth of the private sector, that we began to make progress. This is reason enough to ignore our right-wing critics. □

# Who Gains What from Farm Programs?

by Bruce L. Gardner

*The labyrinth of regulatory and bureaucratic snafus which are part and parcel of this nation's agricultural support programs insulate these same programs from concise, market-oriented criticism. What has been needed for some time is a clear and comprehensive exposition of our farm programs, accompanied by a bottom-line cost analysis of the prices we pay for farm supports. Bruce L. Gardner, economics professor at the University of Maryland and one of the nation's leading scholars in the field of agricultural economics, has now provided us with just such a study.*

*In the new ICEPS book The Governing of Agriculture (Regents Press), Prof. Gardner provides succinct analyses and detailed information concerning our farm programs which will be utilized by agricultural economists and policy makers alike. John McClaghry, Senior Policy Advisor to the President, commented, "We need an intellectually sound analysis of government intervention in agriculture. ICEPS has done a real service by bringing this book out."*

*In the following article, Prof. Gardner presents a cost-benefit analysis of particular farm programs, focusing on the effect of price supports and quotas on land used to grow tobacco.*

There are numerous estimates of the budgetary costs of the farm programs. Congress requires information on the subject for its appropriations bills, and the executive branch needs estimates for budgetary planning. Any such estimates, however, are conjectural, given our lack of knowledge concerning random exogenous influences on the product markets and concerning how producers will respond to the policy interventions. Moreover, estimates of budgetary costs usually combine such disparate items as deficiency payments, which are a direct transfer to farmers, and loan outlays from the Commodity Credit Corporation (CCC), which are not

(since the CCC acquires grain as an asset to offset the loan outlay).

To get a rough feel for the potential overall economic impact of transfers under current programs, the table below lists estimates for the commodities that are most significantly affected.

In the "ratio of price" column, prices received by producers in 1978/79 are compared to an estimate of what the market price would be in the absence of price supports and production controls. For the major crops, these figures result from the crude calculations outlined above, which provide a rough estimate of income transfers under each program, bringing together some order-of-magnitude judgments. Note that the total costs to taxpayers and consumers exceed the gains to producers by about \$1.5 billion. This is a rough estimate of the net social costs of the programs. Given that in 1979 the USDA employed 876 economists and that about an equal number of agricultural economists worked at land-grant (federally funded) state universities, one might hope for more precise and reliable estimates, but they do not exist to my knowledge.

## Land and Quotas

The question of who gains from a price-support program depends on who owns the resources that will gain most by intensification of effort in producing the supported crop. It seems obvious that the most-favored inputs will be resources whose supply is limited and for which there are no good substitutes.

What are the limiting factors in the production of a farm commodity? More precisely, what input is least elastic in supply? Land. When production increases, land that had been better suited to other uses is brought into the industry. Land that is already being used in producing the supported commodity therefore earns rents. If

SUMMARY ESTIMATES OF THE EFFECTS OF FARM PROGRAMS IN 1978/79

COMMODITY	PERCENTAGE OF U.S. TOTAL FARM OUTPUT	RATIO OF PRICE WITH PROGRAMS TO PRICE WITHOUT PROGRAMS	COST TO TAXPAYERS	COST TO CONSUMERS (in millions)	GAIN TO PRODUCERS
Wheat .....	6	1.175	\$1,100	\$ 400	\$1,300
Feed grains .....	12	1.06	1,020	700	1,500
Rice .....	1	1.02	10	0	10
Cotton .....	4	1.02	90	0	90
Tobacco .....	2	1.33	0	425	400
Sugar .....	1	1.88	-770	1,440	600
Peanuts .....	1	1.4	0	200	200
Cattle .....	21	1.035	-40	1,200	1,100
Milk .....	12	1.11		1,500	1,200
Wool .....	0.2	1.3	30	-15	15
All other .....	40	1.0	0	0	0
Total (or Mean) .....	100	1.06	\$1,440	\$5,850	\$6,415

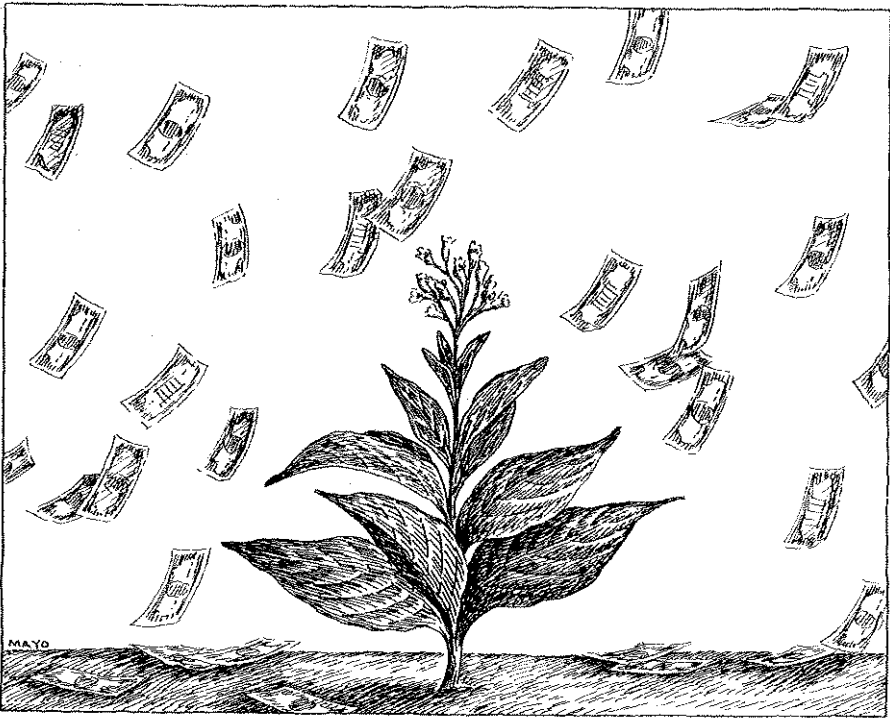
*The total costs of farm programs to taxpayers exceed the gains to producers by \$1.5 billion.*

the supported commodity uses only a small proportion of the nation's cropland and if there is a substantial pool of land in other crops that can be moved over to the supported crop, even the gains to land may not be great. The gains to land become dominant when one considers a system of price supports for a number of farm commodities. The supply of cropland to agriculture as a whole is quite inelastic compared to the supply of labor and purchased inputs, so that owners of land tend to be the principal gainers from farm programs.

The capitalization of price supports into asset values can be observed most readily in the

value of about \$1.20 per pound. The high implicit discount rate on the future rental value of a quota presumably reflects doubt about the future of the tobacco program.

Because the benefits of price-support programs are capitalized into the prices for fixed resources, the real beneficiaries of the programs are quite different from what one might expect at first glance. The gainers depend, not on who produces how much of which commodities, but on who owns the fixed resources that experience increases in price. And it makes a great deal of difference at what time the owner acquired the resource. Someone who bought a tobacco quota



case of tobacco land, because benefits are tied directly to the quotas that limit the marketings of the crop, which are explicitly tied to land and may be bought and sold with land. Moreover, a quota can be leased (within counties) independently of the land, so that one landowner can rent out his quota to another, and a single operator can enlarge his operation by accumulating quotas leased from other farm operators. Although marketing quotas have no inherent productive value, under the program they function as a fixed input for which no substitute exists. As such, quotas earn rents which provide a market measure of the expected benefits of the program. Market data indicate that a tobacco quota rents for about one fourth of its sale value. For example, in 1978, a quota that rented for around 30 cents per pound would have a sale

at \$1.20 per pound would capture little of the gains that result from the programs. However, these individuals would suffer capital losses if the programs were ended. Because of the highly leveraged position of many landowners, especially younger farmers, there exists a great risk of loss if the programs were to end. The situation is analogous to the body's addiction to certain drugs. Our bodies become adapted to an altered state, so that after the initial period of adjustment, the altered state becomes "normal." When this situation has been reached, severe withdrawal symptoms appear if one tries to return to the predrug state. So it is with the position of farmers under commodity programs.

Fortunately, from this point of view, the current programs for the major crops are in such a

*(Continued on page 6)*

# Farm Programs

(Continued from page 5)

state of flux and are so complicated and so uncertain—as to their effects on the markets—that it seems unlikely that they have yet had strong effects on the prices of assets. Even for tobacco, the longest-running and apparently most stable commodity program in existence today, program-created assets that rent for 30 cents sell for \$1.20, suggesting a market estimate that the future benefits of the program are in doubt. In this situation, ending the tobacco program immediately would result in a \$1.20-per-pound unanticipated capital loss for owners of a quota. But prolonging the program for more than four years at present effectiveness would result in an unanticipated capital gain.

## The Social Costs of Current Programs

The identification of gainers and losers from farm programs is very difficult, but it is necessary if one is to understand why we have these programs and what their effects are. Still more important, and more difficult to estimate, are the social costs mentioned earlier—the costs that consumers and taxpayers give up but that *nobody* gains. The earlier discussion suggested social costs that added up to perhaps one and a half billion dollars in 1978 due to restricted U.S. consumption. Yet these calculations leave out much that constitutes the real social costs of our farm policies.

The social costs result, in the cases considered, because programs cause too high prices and too little consumption. But in some cases where the programs have a small or not easily determined effect, there are still real problems.

Consider wheat. Many programs impinge on the wheat market, with a bewildering array of incentives and counterincentives. Target prices encourage increased production, while set-asides simultaneously try to hold production down. At the same time that we are trying to control production, we have government-sponsored research to increase yields; a research and promotion program to encourage domestic wheat consumption; a federal grain-inspection program, as well as other measures to encourage exports; and the CCC loan program and storage-construction loans to increase stocks. The target-price program encourages increased yields per acre by means of the increased use of fertilizer, pesticides, and other inputs; whereas the disaster-payments program encourages farmers to exercise less care in production practices generally, and so encourages lower yields. Finally, we have P.L. 480 and CCC export credit to boost demand further, and a menu of voluntary diversion and other production-control authorities which are available at the discretion

of the secretary of agriculture, together with his authority to cut loan rates, manipulate storage subsidies and release prices, purchase surplus commodities for school-lunch programs, impose export subsidies, make payments for wheat acreage that is grazed out, provide emergency relief, and establish import controls. Such is the program that has been advertised under the label “market-oriented.”

The simultaneous attempts to reduce supply and to increase demand could possibly result in the same output of wheat as if there were no programs at all. But we cannot therefore assume that these programs may be simple transfers of income with no resource misallocation or social costs. The net social costs of our farm programs include the funds and manpower expended in concocting and administering these programs as well as the time and effort spent by farmers in attempting to become informed about them, to comply with them, or to subvert their intention. One must also factor in the costs incurred when political representatives of farm interests engage in congressional lobbying for promotion of their legislative goodies.

While it is not possible to provide a precise estimate of these costs, they are quite likely to equal the conventional measured social costs. For example, counting ASCS employees, members of county committees, related USDA and congressional staff, and commodity-group analysts, probably at least twenty thousand work-years are devoted to farm-program affairs. At the ASCS average compensation of \$15,000, this would amount to \$300 million annually, which we probably ought to increase by 50 percent for overhead costs.

With administrative costs added to the figures in our table, the estimate of net social loss due to the farm programs would be increased to the neighborhood of \$2 billion. The following line of argument suggests a much higher estimate. Producer interests have been able to persuade the U.S. government to transfer roughly \$6 billion to them from their fellow citizens. Given rewards of this magnitude, and given the fact that lobbying and other political activity is open to all, one would expect roughly comparable amounts to have been spent in obtaining the transfers. Moreover, since it would be worth \$6 billion to nonagricultural interests to have these transfers end, one might expect a tendency, on the part of nonagricultural interests, toward willingness to spend comparable sums on political activity. While this is a conjectural and empirically unconfirmed calculation, this reasoning suggests that we ought at least to consider the idea of counting the whole \$6 billion that is transferred as net social loss. □

## MR Interviews Cong. Philip Gramm

*The tax battle is over. What began in the late Seventies as a "radical, Republican tax bill" will now be recorded as one of the most successfully coordinated bipartisan economic packages in history. In battles such as these, individuals do make a difference. Surely, President Reagan's personal call to the people was paramount in convincing some Democrats to vote for the tax bill. However, the herculean effort of Congressman Philip Gramm (D-Texas) to rally fellow Democrats around the concept of a supply-side tax cut deserves more than a passing reference in the history books.*

Prior to his election to the 96th Congress in 1978, Philip Gramm was a full professor of economics at Texas A&M, where he had been teaching since 1967. During the course of his academic career, Prof. Gramm published five books and monographs, over 50 professional articles, and over 100 articles for the general public. He has worked as an economic consultant for the public Health Service (1966-72), the National Science Foundation (1974-75), the Canadian Ministry of Natural Resources (1973-78), and many private concerns. One of the most remarkable things about Phil Gramm is that he is only 39 years old.

A few days prior to the crucial vote in the House, MR Associate Editor Tom Hazlett interviewed Cong. Gramm in Washington. What follows are the candid remarks of a politician concerned more with sound ideas than with hollow rhetoric.

**Manhattan Report**—You have a long-established record as an outspoken critic of politicians in Washington. Now that you're on the inside, is the organizational structure of Congress much different from what you expected?

**Philip Gramm**—I didn't come here with a total lack of knowledge about Congress. I'd been to Washington many times to testify before committees and to lobby on behalf of free enterprise causes. However, I guess there were several things that somewhat surprised me about Washington.

First, I was surprised to find that Congress is loosely organized. The leadership of both parties is not strongly organized, and an individual who does his homework, works hard and is active can have a substantial amount of influence.

**MR**—That was a surprise to you?

**Gramm**—Yes, it was. A second thing has to do with the power of ideas. Keynes wrote that economists and social philosophers are more powerful than is often understood, and that ideas, not vested interests, are important for good or evil. That is certainly true, in the most practical sense, in Washington. Ideas, not vested interests, in the long run dominate even something so practical

as Congressional debate.

**MR**—Why don't you give me an example of that, because that is very controversial.

**Gramm**—I'll give you two examples. The tax debate has now turned into a bidding war, where each side, in essence, is bidding to cut taxes under the banner of creating incentives. That is the result of nothing short of an intellectual revolution in the country and in the Congress. Three years ago people laughed at Jack Kemp. Now, his sternest critic finds himself supporting an elimination of the differential between the so-called earned and unearned income.

Another example: Ten years ago, had we done a survey in the country and asked people what causes inflation, government deficit spending and a rapid growth in the money supply would not have been twentieth on the list. Today, they would be number 1. And the recognition that the public has of the relationship between the deficit and the growth in the money supply and increases in prices is overwhelming. Overwhelming because the relationship between government deficit spending, growth in the money supply and a growth in prices is very complex. But in ten years, we have had the dissemination of information and knowledge which has affected public perception of the problem and has, in turn, affected politics. So, you asked for examples—the two most important issues of the 96th Congress are issues in which ideas, not vested interests, have triumphed.

**MR**—What is the level of economic understanding by most Congressmen?

**Gramm**—It's hard to generalize about 435 people. I am asked questions about what Congressmen are like—what they know about economics, all the time, and it is an impossible question to answer because it varies so much from person to person. If I ever write a book about Congress when I leave here (and, hopefully, I'll have something better to do than write a book about Congress) I will entitle the book, *No Better Than the People*. And, basically, that's what Congress is; no better or worse than the people.

**MR**—What about Phil Gramm selling his fellow Congressmen on ideas? How do they respond to you?

**Gramm**—You'd have to ask them instead of me. Anything I say is going to be self-serving. I was fortunate enough to be here during a time when we had an opportunity to turn the country around. I worked hard to get on the Budget Committee. There was nothing fortunate about that. And I was able to play a small part in putting together a budget package—Gramm I and II—which, for the first time in twenty years, has a real opportunity to reverse the trend towards

## Cong. Philip Gramm

ever-bigger government. Gramm II—the reconciliation package—will be the most significant bill of this decade in terms of making cuts over a three-year period. The cuts are not enough to achieve our goal of a balanced budget. They are not enough to permanently reverse the trend, but they represent a good start. And if we can maintain the momentum we have built here on the budget over the next four years, we can change the country. If we don't, then we will have created a blip on the trend line, and we may have bought another few years in terms of being able to preserve our economic and financial institutions.

**MR**—So the issue is still open?

**Gramm**—Yes.

**MR**—Ronald Reagan seems to have gained in stature since becoming President. Since his election, he seems to have captured the imagination of many of the same people who were ridiculing him at an earlier time. What do you think is the key to the Reagan leadership?

**Gramm**—Well, I think there are two keys. I think one is leadership.

**MR**—That is, personal charisma?

**Gramm**—Yes. Reagan has the ability to communicate with people, and he is obviously a nice guy. He's not easily stereotyped as an uncaring conservative, and that separates him from most people. I think, secondly, the American people, by 1980, had recognized there was a crisis and that a change had to be made. And that has been reflected in a growing, politically active conservatism among people. And I think that, plus the personality and the qualities of the President, combined with the recognition on the part of the American people that we had to try to change things.

**MR**—On the down-side, what has Ronald Reagan done wrong so far?

**Gramm**—Very little. I'm not convinced, in the long run, that even his aborted program on Social Security was a mistake. In the long run, he could benefit politically from that stand if the Social Security system continues to weaken. At least he had courage enough to stand up and speak out on the issue, whereas others have not.

**MR**—Are we really seeing a repeal of the New Deal? Would that be fair to say?

**Gramm**—I wish that were so. I'm not sure. We are seeing the beginning of that process.

**MR**—But, it's going to be a long hard haul.

**Gramm**—Well, it took 30 years to get in as bad a shape as we're in. We're not going to change things in one year.

**MR**—What's the deficit going to be like, and what about the people who claim that your tax cut

is going to be inflationary?

**Gramm**—The people who now claim that the President's tax cut will be inflationary and will contribute to the deficit are the same people who have continually voted in favor of deficit spending and increasing inflation during their congressional careers. So their concerns are quite hollow. Their concern really goes back to their inability to fund social programs. I feel that we have an excellent opportunity to slow down the rate of growth in prices.

**MR**—Going to a different area, do you believe that the energy crisis is over?

**Gramm**—I don't believe it ever started. Our primary problem in energy was that the impact of our regulatory policy made us vulnerable to a foreign embargo. We are in a transition period on energy. We were the only nation in the world with gas lines at the filling stations because we had regulated prices. I believe that the market system is capable of dealing with energy problems if we will allow incentives to be created for conservation and for production.

**MR**—But, presumably, we have achieved that through decontrol.

**Gramm**—Well, we have decontrol of oil, but we're still controlling natural gas. As a result, oil drilling is way up, but well completion for natural gas is lagging behind, as we appraise natural gas at less than half of its market value. We are seeing tremendous misallocation of resources.

**MR**—So you would be in favor of immediately deregulating natural gas?

**Gramm**—No, I am in favor of setting up a system to achieve deregulation of all natural gas by



**Congressman Philip Gramm**

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*"The people who now claim that the President's tax cuts will contribute to the deficit are the same people who continually voted in favor of deficit spending."*

1985. Under the Natural Gas Policy Act, gas discovered after 1977 will be deregulated on a phased basis. But it is being deregulated up to a price that is about one-half of the price of natural gas on the free market. The rest of the gas will not be deregulated. The Natural Gas Policy Act is so flawed that unless we take action now, there is a very good chance we will not see deregulation in 1985.

**MR**—Some critics of the Reagan administration are saying Reagan will not act as quickly on deregulation as President Carter did. We are certainly seeing some of that, for instance, in the Interstate Commerce Commission.

**Gramm**—It's the difference between actions and words. On words, Jimmy Carter was lightning; on actions, he was a snail. The Reagan administration has talked very little about deregulation, but it has taken giant steps through decisions within government agencies. I think we will be moving into that area.

You can't fight battles on all fronts at once, and it was imperative to get the tax cuts and the budget cuts out of the way first. So, Reagan has made more progress in six months than Carter made in four years. He has not talked about deregulation, but he has done more.

**MR**—Would you give me an example of the decisions that are leading to deregulation?

**Gramm**—I can give you a whole range of moves by OMB that have reduced regulatory costs by over \$8 billion. Not things that have gotten into the headlines, but simply changes in rule-making and regulatory changes in government agencies. We have tremendous possibilities there because most of the laws that have given us problems have been laws where the Congress let the bureaucracy make decisions. That whole process can, very quietly, be reversed. And it is being reversed.

**MR**—Would you have a comment on Stigler's thesis on special interest control?

**Gramm**—I wrote an article a few months ago which, basically, was an explanation of the deficit. It went on to explain that the average spending bill we voted on in the last Congress cost about \$50 million. The average beneficiary got between \$500 and \$700. There are 100 million taxpayers, so the average taxpayer paid 50 cents. You don't need a lot of economics to understand that somebody getting \$700 is willing to do a lot more than somebody who is paying 50 cents. So, every time you vote on every issue, all the people who want the program are looking over your right shoulder and nobody's looking over your left shoulder. They're sending letters back home telling people whether Phil Gramm cares about the old, the poor, the sick, the bicycle

riders . . . the list goes on. It's perfectly legitimate. The problem is that nobody's looking over the left shoulder. As an example, we had to vote individually on the twice-a-year cost of living adjustments for Federal employees because a conservative Republican asked for a separate vote, and, whereas it passed by 270 some-odd votes, only 59 people, approximately, voted for the cut on the floor. I received over a thousand letters in opposition to the cut. The largest National Association of Retired Federal Employees chapter in my district cancelled the speech I was to give three days before the general election. They put my name in their national newsletter as one of their enemies . . . all of it perfectly legitimate. The problem is that we went out and did a survey in my district, and not one person in 10,000 who was not a Federal employee knew how I had voted. So in being fiscally responsible under such circumstances, we're asking more of people than the Lord asks. At least I know if I do good—if I take the bible literally—when I get to Heaven, it's going to be written in the Golden Book. I know here it will never be known.

**MR**—What about the power of the bureaucracy itself to sabotage reform? Is it impregnable?

**Gramm**—No, I don't think it is. It is impregnable if people are unwilling to make difficult decisions. But as the Reagan administration has shown, when you get right down to it, there are a lot of cows that claim to be sacred, but there are not really many that are.

**MR**—Well, let me just throw out an example: Social Security.

**Gramm**—We cut Social Security twice in Gramm-Latta. That's a perfect example. Nobody would have thought it was possible. We eliminated student benefits and minimum benefits cold turkey.

**MR**—So there are no sacred cows any more.

**Gramm**—No. The only sacred cow is the long run survival and prosperity of the American people.

**MR**—What is the future of the Democratic Party?

**Gramm**—I think it depends. If people like Chuck Manatt [Chairman of the National Democratic Committee] have their way, then it will become a minority party. I don't accept Chuck Manatt as the final arbiter of what the Democratic Party's position is or should be, so it's hard to say.

**MR**—Given that, and given the fact that there are a lot of people who lead the Democratic Party who are going to have to defend that position, isn't Phil Gramm in trouble in the Democratic Party?

*(Continued on back cover)*

## Free-Market Environmentalism

Mention the term "environmentalism" and few people think of the free market. The economic impact of environmentalist legislation has been to curtail market activity in favor of government involvement in wildlife management and pollution control. Imagine, then, a group of committed environmentalists, all with distinguished backgrounds in economics, convinced that the only hope for preserving our natural wilderness areas is the free market. Unusual? Certainly. Impossible? Not at all.

The Center for Political Economy and Natural Resources at Montana State University is run by an enterprising group of "free-market environmentalists." Twice in the past four months the Center has called on ICEPS to help pull together economic policy experts and journalists for conferences in Montana. In June, the Center sponsored a conference on natural resources at which several ICEPS associates participated. Several radio commentators for ICEPS's PERSPECTIVE ON THE ECONOMY were present, including Tom Bethell, Washington editor for *Harper's*, Robert Poole, editor of *Reason* magazine, and Richard McKenzie, Professor of Economics at Clemson University. Also attending the June conference were ICEPS's President William Hammett and *New York Post* financial editor Maxwell Newton, a frequent participant at ICEPS gatherings in New York.

At a more recent symposium, *MR* had a chance to interview the two co-directors of the Center and one of its chief researchers. As we sat in the crisp mountain air of Southern Montana, the three economists—each of whom had been brought up in the region and have a deep respect for the area—spoke of the environmental lobbyists and bureaucrats in Washington, D.C. "No East Coast liberal can tell me he cares more about this region than I do," John Baden, director of the Center, began, as he stuck another pinch of tobacco between his lip and gum. Baden spends part of his time running a Montana sheep ranch and therefore has a vested interest in preserving the natural grazing areas which comprise much of the Montana wilder-

ness. "What few so-called environmentalists understand," continued Baden, "is that government control and intervention is no guarantee of environmental protection. In fact, very often the environment suffers precisely because of government involvement." As Milton Friedman has pointed out, the collusive relationship between special interest groups and government bureaucracies can result in far more damage to society (and the environment) than the actions of individuals operating within an open market.

Richard Stroup, co-director of the Center and noted economist (his textbook, *Economics: Private and Public Choice*, has just surpassed Samuelson's in book sales), has written extensively on the negative impact of the government on the environment. He is replete with examples of this but favors citing The Bureau of Land Management's practice of "chaining." Chaining involves dragging 600 feet of heavy anchor chain between two powerful crawler tractors to uproot pinon and juniper trees. This improves the grass for the benefit of ranchers leasing government land. However, no rancher working alone ever chains his own land; the cost/benefit relationship makes such an effort unprofitable. Thus, the environment suffers as a result of government's efforts to "manage the land." "The key to protecting the wilderness we cherish," explains Stroup, "is the ability to hold individuals accountable for their actions. When land is held by the government and leased out, it is much more difficult to affix accountability."

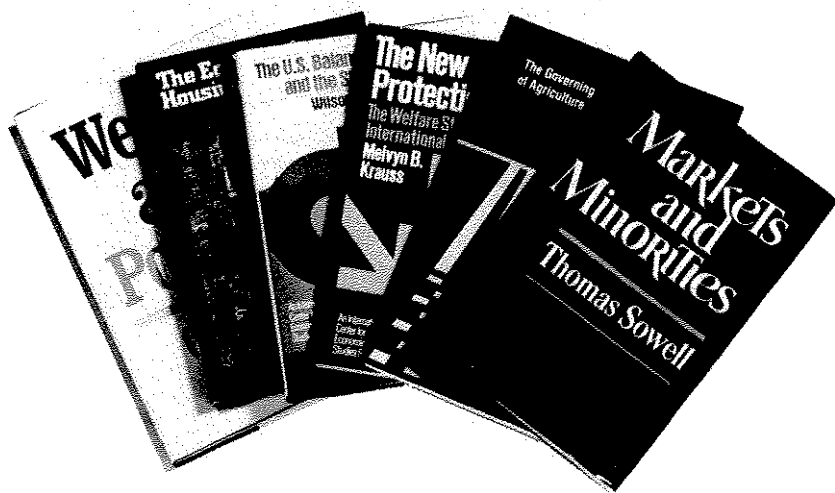
Economist Terry Anderson, who began his studies as a forestry major and was a fellow at the Hoover Institution before joining the Center in 1972, picked up on the theme of accountability. "A property-rights approach to a quality environment could combine accountability for actions with an emphasis on the basic incentives that make our economy work."

The Center for Political Economy and Natural Resources has recently embarked on a very exciting research project. New studies are being prepared which detail unique methods of privatization of public holdings—not only with regard to divestiture of public lands, but also with regard to privatization of public, bureaucratic institutions. Already Administrative officials have shown interest in using the Center's plans as blueprints for policy decisions. To insure that these plans receive wide circulation both among policy makers in Washington and among media outlets in New York, ICEPS will continue working closely with the Center as its research is readied for distribution. We are pleased to work with a group of accomplished economists whose commitment to environmentalism is matched by their deep concern for individual liberty. □



John Baden at the podium

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## Cong. Philip Gramm

*(Continued from page 9)*

**Gramm**—I think the Democratic Party's in trouble — not Phil Gramm. I'm riding my donkey off into the sunset following Thomas Jefferson, who said, "If we can prevent the government from wasting the labors of the people under the pretense of caring for them, they will be happy." So I'm on the right side. I'm on Jefferson's side. I don't know who these other boys are following, but in my opinion, they're going down the wrong road.

**MR**—You've had a couple of votes that surprised some of your ideological brethren. For instance, can you defend your vote in favor of creating the Department of Education?

**Gramm**—First of all, we didn't create a new department. We broke up an old department. We didn't hire a single new person. We reduced the overall budget by \$50 million. All we did was to take an agency that was absolutely uncontrollable — because its political base was so broad that it was impossible to control — and by breaking it apart, we were able to get greater accountability. The budget of H. E. W. had grown at 16% a year over the last decade. By breaking out education, we were able not only for the first time to begin to impose some constraints on Federal involvement in education, but we controlled the growth of its budget, holding that growth at 5.9%. We also got it out in the open

where we had a real opportunity to end Federal involvement in education and eliminate the Department of Education altogether. As I have told the President, if by eliminating the Department of Education you mean shutting it down and firing people, I'm for it. But if you mean putting all those people back in H. E. W. so we don't know they are there, then I'm against it.

**MR**—What can economists learn from Washington?

**Gramm**—Economists have to learn to talk to politicians. What economists really have to say to the politician was well understood by Alfred Marshall and Adam Smith, and that is the basic idea of how markets work and what causes inflation.

**MR**—So you consider yourself fortunate to have had the sort of academic background you had before coming here.

**Gramm**—Well, I enjoyed it, and I got paid for twelve years to sit around and think about things. It's a luxury very few people have, and it obviously was to some advantage.

**MR**—And you're still wearing your Adam Smith tie.

**Gramm**—That's correct.

**MR**—Thank you very much for your time, Congressman. □

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