Notes

Chapter 1


2. An article in the Wall Street Journal pointed out how much President Clinton had moved since the previous year. Whereas the previous year’s (February 1995) budget proposal had projected deficits of $200 billion per year for the foreseeable future and contained five years of spending cuts totally $81 billion, the 1996 proposal had increased the projected cuts to $234 billion, permitting a deficit of zero by 2002 providing the economy remained at a steady rate of growth. With this reversal, President Clinton had surrendered to the Republicans. See Jackie Calmes, “Clinton’s Fiscal ’97 Budget Reflects Major Shift toward Ending Deficits and ‘Big Government,’” Wall Street Journal, February 6, 1996, A16.


4. The most significant cuts in the 1995 budget that Congress had passed and that the president had vetoed were in the Medicare and Medicaid programs. To measure such cuts, the Congressional Budget Office (CBO) starts with a “baseline budget.” This budget indicates how much it would cost to maintain current services over the period of time being considered, based on the CBO’s estimates of costs and revenues, if no changes were enacted. Then the changes passed by Congress are measured against this baseline. This procedure is the source of the argument as to whether these are cuts or merely slowing the growth of spending. In fact, slowing the growth of spending makes it impossible to provide services at the current level to the growing population eligible for those services (the retired, the poor, the disabled in the case of Medicare and Medicaid) with the increased cost of providing those services over time. In December 1995, compared to the CBO baseline, recalculated according to the most recent predictions about the economy’s next six years, the budget passed by Congress would have reduced federal spending by approximately $401 billion, of which approximately $359 billion would have been in Medicare and Medicaid. It also would have cut taxes approximately $229 billion (Jim Horney, “Memorandum: Updated Estimates of the Balanced Budget Act of 1995,” Congressional Budget Office, December 13, 1995). The 1997 law, by
contrast, cut approximately $127 billion in toto while providing a modest $90 billion in tax reductions (and an additional $11 billion in refundable tax credits) through 2002 (see “Budgetary Implications of the Taxpayer Relief Act of 1997” and “Budgetary Implications of the Balanced Budget Act of 1997” in letter, June E. O’Neill, director, Congressional Budget Office, to Franklin D. Raines, director, Office of Management and Budget, August 12, 1997.)

5. For an analysis of Clinton’s goals and methods on the road to this compromise see Martin Walker, “He Stoops to Conquer: Clinton’s Budget Pact Shows His Messy Means to a Grand End,” *Washington Post*, May 11, 1997, C1, C5. For initial coverage of the agreement, see the *New York Times*, July 30, 1997, A16, A17.

6. The Employment Act of 1946 states that

it is the continuing policy and responsibility of the Federal Government to use all practicable means, consistent with its needs and obligations and other essential considerations of national policy with the assistance and cooperation of industry, agriculture, labor, and State and local government, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power. (Quoted in Stephen Kemp Bailey, *Congress Makes a Law* [New York: Columbia University Press, 1950], 228.)

The responsibility to “promote maximum employment” has been interpreted as requiring efforts to respond to the increase in unemployment that accompanies recessions. In 1978, this law was amended by the Full Employment and Balanced Growth Act to include a specific target of 4 percent unemployment.

7. There is a significant strand in economic analysis that suggests that paying the unemployed compensation may actually delay workers’ finding new jobs because the benefit subsidizes the time without a job and reduces the urgency with which they look. See Martin Feldstein, “The Economics of the New Unemployment,” *Public Interest* 33 (1973): 3–42. Similarly, there is a strongly held view, exemplified by the work of Charles Murray in *Losing Ground: American Social Policy, 1950–1980* (New York: Basic Books, 1984), that providing cash assistance to the poor as welfare actually causes poverty rather than reducing it. This point of view became the intellectual justification for the Republican proposals that led ultimately to the abolition of Aid to Families with Dependent Children, the program that provided a federally guaranteed cash grant to children in poor, single-parent families.

8. To give one example, total federal spending as a percentage of total economic activity (gross domestic product) stayed around 10 percent for the entire decade of the 1930s, rose to around 15 percent after World War II, hovered around 19 percent from the end of the Korean War till the late 1960s, and climbed to near 21 percent by 1979 (*Economic Report of the President* 1996 [Washington, DC: Government Printing Office, 1996], 368; henceforth these annual reports are abbreviated ERP, with the year indicated). Considering total government expenditures (including state and local outlays for things like police, fire, education, and public
assistance), we see an upward trend from 25 percent of total activity to 30 percent between 1960 and 1979.

9. The United States Central Bank consists of a system of twelve regional federal reserve banks whose actions are controlled by a seven-member Board of Governors in Washington appointed by the president (and subject to confirmation by the Senate) for fourteen-year terms. However, for the most important policy decisions, the controlling unit is the larger Federal Open Market Committee, which consists of the seven governors and the presidents of five of the regional banks (with the president of the New York Federal Reserve Bank always among the five). The actions of the Federal Reserve System are completely independent of the three branches of government, except that Congress may change the rules by legislation at any time. The president and secretary of the Treasury have no direct influence on Federal Reserve policy. All they can do is make speeches and attempt persuasion. A president wanting to force a change in policy would have to propose legislation to Congress. For a massive study of both the history and recent experience of the Federal Reserve System, see William Greider, *The Secrets of the Temple: How the Federal Reserve Runs the Country* (New York: Simon and Schuster, 1987).

10. A more detailed table, which goes back only to 1968, is provided in the *1996 Green Book*, 1321. Programs redistributing income on the basis of need for medical, food, and cash assistance went from 4.9 percent of the federal budget (in 1968) to 8.5 percent of the budget in 1978. Note that these are fiscal years, not calendar years. The fiscal year went from June of the previous year to the end of May of the numbered year until 1976; and from 1977 on, from October 1 of the previous year to the end of September of the numbered year. Thus, “fiscal 1968” was from June 1, 1967 to May 31, 1968. “Fiscal 1978” was from October 1, 1977 to September 30, 1978.


12. The Congressional Budget Office analysis of the 1997 law shows a cut in Medicare spending of $115 billion in the years 1998 to 2002 over the predicted path of spending if no changes were to occur. See letter, June E. O’Neill, director, Congressional Budget Office, to Senator Pete V. Domenici, chairman, Committee of the Budget, United States Senate, July 30, 1997, table 4.


15. Representative Meek had asserted that

in 1980 a group of Republican candidates came to the Capitol steps and pledged that, if elected they would enact a supply-side miracle that would raise defense spending, cut taxes across the board, and still eliminate the deficit in 4 years. . . . They rammed their supply-side quick-fix through the Congress, and claimed it would solve all of our problems. . . . Their latest contract calls for: Another round of defense spending increases and a longer list of pie in the sky tax cuts.

What they do not tell us is that their contract will do two other things: First blow a $1 trillion hole into their balanced budget promise; and sec-
ond, produce another tax windfall for the wealthy while leaving the middle class and the poor behind. (Congressional Record [September 29, 1994], 10254)

16. For example, see the following remarks by Speaker-designate Newt Gingrich on November 11, 1994: “It is impossible to take the Great Society structure of bureaucracy, the redistributionist model of how wealth is acquired, . . . and have any hope of fixing them. They are a disaster. They . . . have to be replaced thoroughly from the ground up” (Contract with America, 189).

17. It should be noted that some scholars and not a few citizens believe that this theoretical analysis is just a veneer behind which the true purpose of economic policy is to redistribute income and opportunity to those already in power, who have always been able to manipulate the political system to their ends. Thus, the role of government has always been rather extensive, and the cry for less government involvement always ignores the things government does to subsidize investments and profits of already large and successful enterprises. (On this point, note the increase in government activity and spending related to law enforcement, the punishment of criminals, and the defense establishment promised by the Republicans in the Contract with America, 37–64, 91–113.) This book will allude to this alternative point of view at times, but for the most part, we will conduct our discussion based on the mainstream analysis. The reason is that even if this alternative explanation of economic policymaking were true (and there is plenty in the historical record consistent with it), the changes in policy during the 1980–97 period are significant and worth exploring on their own terms. Second, the debates in the mainstream do not credit this alternative approach, and in the interest of dialogue with that mainstream, it is essential to accept some of the most basic premises, at least for the sake of the current discussion.


19. The economic proposals are contained in the following promised laws: “The Fiscal Responsibility Act . . . The Personal Responsibility Act . . . The American Dream Restoration Act . . . The Senior Citizens Fairness Act . . . The Job Creation and Wage Enhancement Act” (Contract with America, 9–10; see also 17–18). The specific proposals in these laws were a balanced-budget amendment to the Constitution, a denial of welfare to minor mothers, a rigid two-years-and-out limit on welfare eligibility and a cut in the dollars available for welfare, a five-hundred-dollar-per-child tax credit for all taxpayers making up to two hundred thousand dollars a year, an increase in the amount of money Social Security recipients can earn while collecting their pensions, a repeal in the 1993 tax increases on some Social Security income, a cut in taxes on business income including capital gains, and a reduction in government regulation of business and federal regulation of the states.


21. The marginal tax rate is the percentage of the next dollar you stand to
earn by, say, accepting a higher-paying job that you would have to pay in taxes. With a tax system that starts with some income free of taxation and then has a series of rising rates (such as our federal income tax system), the average tax rate is just the total level of taxes divided by total income. The marginal rate will always be higher than the average rate so long as some income is tax free (and therefore subject to a zero rate). It is the contention of some economists, including Lindsey, that high marginal tax rates discourage productive economic activity. See Lawrence B. Lindsey, “Simulating the Response of Taxpayers to Changes in Tax Rates,” Ph.D. diss., Harvard University, 1985. For a concise, less technical discussion, see Lawrence B. Lindsey, The Growth Experiment: How the New Tax Policy Is Transforming the U.S. Economy (New York: Basic Books, 1990), 53–80.


23. A supporter of Reagan-style tax cuts even before Reagan was elected president, Jude Wanniski wrote a book (How the World Works [New York: Touchstone/Simon and Schuster, 1978]) arguing that the ups and downs in all of world history can be traced to regimes of low versus high taxation.


25. Still others deny that the distribution of income has become more unequal.

Chapter 2

1. “Oeconomicus,” Xenophon in Seven Volumes, trans. E. C. Marchant (Cambridge: Harvard University Press, 1968), vol. 4. The original conception of the ancient Greeks and Romans was very practically related to personal management of one’s property (vii).

2. However, as noted in the previous chapter, income distribution is very important as a political issue. There is also an argument from the radical tradition in economics that the distribution of income and wealth has an important impact on economic growth. See pp. 59–63.

3. Of course this is in societies like the United States. In most traditional societies (and human beings lived in such traditional societies for hundreds of thousands of years before settled agriculture and civilization developed more complex organizations for producing food, clothing and shelter) cooperation occurs without modern-style leadership. True, there was a designated leader, but tasks were carried out based on tradition, not direct orders. Even in the United States and other modern economies, the leadership of certain organizations, such as cooperatives and partnerships, is not so hierarchical. Here voluntary cooperation
is much more explicit, and, in fact, in many cooperatives extensive rules govern that cooperation.


5. In fact, even in the classic management literature, both the necessity of imposing order and maintaining control (the Marxist emphasis) and the fostering of a cooperative spirit coexist. For example, Henri Fayol, who published *Administration industrielle et generale* in 1916 (*General and Industrial Management*, trans. Constance Storrs [London: Isaac Pitman and Sons, 1949]), listed fourteen universal principles of management. Though most of the principles emphasize centralizing control over the work process (and therefore over the workers) in the hands of management (19–40), there is an intriguing fourteenth point, “Esprit de corps . . . Harmony, union among the personnel of a concern, is great strength in that concern” (40). In the late 1920s, the famous Hawthorne studies discovered (quite inadvertently) that varying physical surroundings of workers had much less important an effect on how well and hard they worked than did the attitudes of the workers themselves. Elton Mayo quoted from a private internal report on these studies as follows,

The changed working conditions have resulted in creating an eagerness on the part of operators to come to work in the morning . . .

The operators have no clear idea as to why they are able to produce more in the test room; but . . . there is the feeling that better output is in some way related to the distinctly pleasanter, freer, and happier working conditions . . .

. . . much can be gained industrially by carrying greater personal consideration to the lowest levels of employment. (*The Human Problems of an Industrial Civilization* [New York: Viking, 1960], 65–67)

The inescapable conclusion of the Hawthorne Studies was that emotional factors related to morale were more important in determining the productivity of workers than physical factors.

Mary Parker Follet, lecturing in 1933, felt that she had discerned among the most forward-looking businesses the practice of developing collective responsibility, not only between different branches of the administration of a business, but down to the workers on the shop floor,

wherever men or groups think of themselves not only as responsible for their own work, but as sharing in a responsibility for the whole enterprise, there is much greater chance of success for that enterprise . . . when you can develop a sense of collective responsibility then you find that the workman is more careful of material, that he saves time in lost motions, in talking over his grievances, that he helps the new hand by explaining things to him and so on. (*Freedom and Co-Ordination, Lectures in Business Organization* [New York: Garland, 1987], 73)

I am indebted to my colleagues Julie Siciliano and Peter Hess of the Department of Management at Western New England College for calling my attention to these sources.
6. In the context of environmental degradation and fears of world overpopulation, to state that growth appears to have become permanent since the Industrial Revolution might be considered the height of hubris. I do not want to underestimate the dangers posed by environmental deterioration. However, it is a fact that the increased knowledge that has created the technology that is endangering our planet has also given us the potential information necessary to harness the technology and, in the words of the ecologist Barry Commoner “make our peace” with the planet (Making Peace with the Planet [New York: Pantheon, 1990]).

7. The importance of government in stimulating private investment with subsidies and other incentives should not be underestimated. For example, at the height of the laissez-faire approach to free enterprise during the nineteenth century, the U.S. government provided a tremendous subsidy to the railroads. First the government used the armed forces to defeat the Plains Indians and remove them from their land. Second, the government granted thousands of acres of land to the railroads along their right of way, land that the railroads were able to sell quite profitably. Virtually every major surge in investment in the United States can be traced to indirect or direct subsidies as a result of government activity, whether making war, building roads, or the like. Nevertheless, it is true that the actual spending of the investment funds is done by a private entity.

8. Contract with America, 23.

9. H. Ross Perot in United We Stand emphasized the interest burden on the federal taxpayer of the four-trillion-dollar national debt. He asserted,

By 2000 we could well have an $8-trillion debt. Today all the income taxes collected from the states west of the Mississippi go to pay the interest on that debt. By 2000 we will have to add to that all the income tax revenues from Ohio, Pennsylvania, Virginia, North Carolina, New York and six other states just to pay the interest on that $8 trillion.

Central to the criticism leveled by Perot at the political leaders is a linkage between the unacceptable behavior of the economy in the 1990s and the ballooning national debt. In his very first chapter, he begins by mentioning some large layoffs. He then mentions the national debt and its growth every day as a result of the government deficit and concludes, “Does anyone think the present recession just fell out of the sky?” (United We Stand: How We Can Take Back Our Country [New York: Hyperion, 1992], 5). The reader is left with the inescapable conclusion that Perot wants us to believe the large debt caused the recession. We will explore these and other arguments about the alleged burdens of deficits and debt below. See pp. 43–44, 162–63, 170–74.

10. In Restoring the Dream, ed. Stephen Moore (New York: Times Books, 1995), 65–81, the House Republicans continue their arguments and promises made in the Contract with America. Their laments about the damage being done by budget deficits adds virtually nothing to what was said in the first volume. There is a reference to the absorption of national savings, the problem just referred to of “crowding out” private investment. The only other specific problems involve the increased percentage of federal spending devoted to interest payments on the debt and a reference to the fact that a rising percentage of the debt is held by foreigners. Both of these “problems” are not as serious as they make them out to be and are discussed on p. 170 and tables N-13 and N-14. Everything else in these pages is just

11. There is a school of economics known as the “public choice” school whose most prominent member, James Buchanan, received the Nobel Prize in economics in 1989. This school contends that there is an inexorable political pressure for government to expand its involvement in the economy based on the self-interest of government officials, elected and appointed, as well as the intensity of desire on the part of beneficiaries of government largesse. According to Buchanan, the future generations who must pay interest on the debt contracted before they were born have no political say in the decisions made by their grandparents, and thus the deck is politically stacked against them. In *Democracy in Deficit: The Political Legacy of Lord Keynes* (New York: Academic Press, 1977), Buchanan together with Richard Wagner blamed deficit spending for the ability of government to increase its spending in the economy. “Elected politicians enjoy spending public monies on projects that yield some demonstrable benefits to their constituents. They do not enjoy imposing taxes on these same constituents. The pre-Keynesian norm of budget balance served to constrain spending proclivities. . . . The Keynesian destruction of this norm . . . effectively removed the constraint” (93–94). Later on, they assert that the “bias toward deficits produces . . . a bias toward growth in the provision of services and transfers through government” (103). For a detailed examination of the “public choice” school, see Shaviro, *Do Deficits Matter?* 87–103.

12. This was baldly admitted by Murray Weidenbaum, the first chairman of the Council of Economic Advisers under President Reagan. At a discussion at the American Enterprise Institute, he candidly explained that concern over the deficit was necessary to counter pressure for increased government spending.

DR. WEIDENBAUM: I’d like to offer, hopefully, some insight into the continuing concern . . . about deficits. I think the underlying concern is . . . to control the growth of government.

And we measure that most conveniently by outlays. Surely the pressure for government spending growth is omnipresent. What is the counter pressure? In the legislative process . . . we’re led back to the concern over deficits. . . .

DR. STEIN [Herbert Stein, former chairman of the Council of Economic Advisers, then resident scholar at the AEI]: But aren’t you worried that the whole trend of this discussion is reducing the inhibitions about running deficits, and therefore, weakening this restraining force against government spending.

DR. WEIDENBAUM: Maybe that’s why I made my comment.
DR. STEIN: Well, that’s a good reason to make the comment but something more needs to be said then. That is, you need to reestablish some defensible reason for not having deficits. If you’ve now told us that they don’t cause inflation, they don’t crowd out. You see, it is not sufficient, as we know, for a group of economists to sit around and say, “Well, a deficit of a hundred billion dollars doesn’t have these adverse effects,” because you’re dealing with a bunch of Congressmen out there, and if we say 100 billion is OK, they will ask why not 200 or why not 300. They have a certain feeling about zero [that is, a balanced budget]. Zero is an intuitively appealing number. But we haven’t found any other intuitively appealing rule, and that’s what we’ve been missing. (American Enterprise Institute, “Public Policy Week,” mimeo transcript, December 8, 1981, qtd. in Robert Bartley, The Seven Fat Years [New York: Free Press, 1992], 191–92)

15. See the quotations from Buchanan in note 11.
16. In fact there is another way a government can finance deficit spending, called “running the printing presses.” It involves printing money and using it to pay for what the government needs. Such behavior had its origins in the days when governments collected precious metals and turned them into coins at the mint. In order to get more coins out of the precious metal, the mint was ordered to mix in some cheap metal with the gold or silver. This process was known as “debasing the currency,” and the result was that the regime’s coinage came into ill repute and individuals did not want to accept it at face value. Recent history has shown that wholesale resort to printing money to finance government expenditures leads to very rapid inflation—such as in Germany in 1922, when millions of marks were needed for a loaf of bread. This result has led many to argue that it is irresponsible to meet government spending needs by printing money over and above tax revenue. Printing bonds and selling them on the open market is considered more responsible because the rising national debt supposedly acts as a check on too much money creation. However, judicious printing of new money to finance some small percentage of the government budget might very well not lead to hyperinflation. This process, technically known as monetizing the debt, is frowned upon mainly because when the government borrows by issuing bonds, bankers make profits by placing them and investors have a secure place to invest funds. If the government just printed money at a slow enough pace not to accelerate inflation, the bankers would be out their cut.
17. The last time the federal government ran a surplus was in fiscal 1969 (ERP 1994: 359).
18. Contract with America, 23.
20. This is probably a good place to mention that much of the argument
against government spending in general is in reality aimed at government activity that redistributes income. As mentioned in chap. 1, the Contract with America, 91–113, called for increased government spending on national defense. The Republican majority in Congress has since 1994 attempted to reverse the decline in defense spending projected by both the Bush and Clinton administrations, while proposing dramatic cuts in Medicaid, Medicare, and transfer payments to the poor. Even those who rail against spending in general usually treat the defense budget as sacrosanct. Many have argued that this is because the defense budget is an indirect subsidy to large businesses, benefiting the kind of people who make large contributions to members of Congress and whose investment activity is the key to economic prosperity. See chap. 9, n. 18.

21. The National Bureau of Economic Research identifies recessions as periods during which the real GDP (that is, GDP corrected for inflation) falls for two consecutive quarters. Table N-1 combines the NBER’s dating of post–World War II business cycles beginning with the 1948 recession. Each peak marks the end of a period of prosperity and the beginning of a recession. Each trough marks the point where a recession bottoms out and a recovery begins. Table N-1 shows the quarter before and after each peak and trough to give an idea of the way unemployment and capacity utilization rates behave around the peaks and troughs of business cycles. Later we will examine these and many other facts of recent economic history quarter by quarter in the years since 1960.

22. Thus, even though the recovery from the 1990 recession began in the first quarter of 1991, there was not one quarter during the rest of 1991 in which real GDP grew as fast as 2 percent (ERP 1997, 307). Thus, it is not surprising that the unemployment rate actually rose from 6.5 percent in the quarter the recovery began to 7.5 percent in the third quarter of 1992 before it began to decline. Similarly, the capacity utilization rate did not reach 80 percent until the fourth quarter of 1992. This made the 1991 recovery the most sluggish in the postwar period.

23. Note that this is a creation of something physical. Common usage often describes investment as any spending of money to acquire an income-generating asset. By that definition, investment includes buying stocks and bonds as well as physical assets like machines and buildings. For the purposes of describing the impact on aggregate demand, however, we restrict the meaning of investment to physical assets. Purely financial investments actually involve the transfer of ownership rights of already created physical assets and thus are not counted as part of the GDP. This is not to suggest that such financial investments are unimportant; far from it. See pp. 128, 156–57 for some discussion of the impacts of purely financial investments.

24. The public-choice field of economics analyzes that government decision making may not respond to an generalized “public interest” but to the narrow interests of particular constituencies. See James Buchanan, The Demand and Supply of Public Goods (Chicago: Rand McNally, 1968).

25. ERP 1997, 37, 38.
27. ERP 1997, 389. These are fiscal years.
28. Real investment as a percentage of real GDP fell from 16 percent to 14 percent between 1984 and 1989 (ERP 1996, 282), the federal deficit fell from 5 percent of GDP in fiscal 1983 to 4 percent of GDP in fiscal 1986, and the national debt fell from 57.6 percent of GDP to 39.5 percent of GDP between 1960 and 1969. As a
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<tr>
<th>Year and Quarter</th>
<th>Peak or Trough</th>
<th>Civilian Unemployment Rate (%)</th>
<th>Capacity Utilization Rate (%)</th>
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<td>3.8</td>
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<td>7.3</td>
<td>81.2</td>
</tr>
<tr>
<td>1980: 3</td>
<td>Trough</td>
<td>7.7</td>
<td>80.0</td>
</tr>
<tr>
<td>1980: 4</td>
<td></td>
<td>7.4</td>
<td>82.0</td>
</tr>
<tr>
<td>1981: 2</td>
<td></td>
<td>7.4</td>
<td>81.1</td>
</tr>
<tr>
<td>1981: 3</td>
<td>Peak</td>
<td>7.4</td>
<td>81.6</td>
</tr>
<tr>
<td>1981: 4</td>
<td></td>
<td>8.2</td>
<td>79.2</td>
</tr>
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<td>1982: 3</td>
<td></td>
<td>9.9</td>
<td>74.4</td>
</tr>
<tr>
<td>1982: 4</td>
<td>Trough</td>
<td>10.7</td>
<td>72.5</td>
</tr>
<tr>
<td>1983: 1</td>
<td></td>
<td>10.4</td>
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<td></td>
<td>5.3</td>
<td>82.4</td>
</tr>
<tr>
<td>1990: 3</td>
<td>Peak</td>
<td>5.6</td>
<td>82.3</td>
</tr>
<tr>
<td>1990: 4</td>
<td></td>
<td>6.0</td>
<td>80.9</td>
</tr>
<tr>
<td>1991: 1</td>
<td>Trough</td>
<td>6.5</td>
<td>78.9</td>
</tr>
<tr>
<td>1991: 2</td>
<td></td>
<td>6.7</td>
<td>78.8</td>
</tr>
</tbody>
</table>

percentage of GDP, this debt is much lower than was the much smaller absolute
debt of $271 billion in 1946 (ERP 1997, 389). The ratio of debt to GDP was over 100%
percent in 1945 and 1946; that is GDP was actually lower than the national debt in
those years.

Chapter 3

1. The rate of growth averaged 4.07 percent between 1960 and 1969 and 2.85

2. For the periods 1960–69 and 1970–79, productivity growth averaged 2.41
   and 1.33 percent, respectively; unemployment averaged 5.58 and 6.21 percent,
   respectively; and capacity utilization averaged 84.86 and 82.58 percent, respectiv-
   ely.

cycle begins with a peak and continues through the next trough to the next peak.
Alternatively, it can begin with a trough and continue through the next peak to the
next trough (see chap. 2, n. 21 and table N-1). The calculation of profit rates is
made for the year before each cyclical peak, since the rate of profit usually turns
down before the whole economy does. Thus, for example, using the profit rate of
1969 in the 1959–68 business cycle would have actually introduced profit data more
appropriate for the next business cycle.

4. I use 1978 as the end point because in 1979 the Census Bureau changed
data collections, and a spurt of unanticipated inflation caused median earnings of
year-round, full-time workers to fall for that year. I did not want that one year’s
experience to skew the data. As it is, the change from the 1960s to the 1970s remains
quite striking.

5. A variety of inflation rates are constructed and published by the various
branches of the federal government. For the purposes of identifying the misery
index, I have chosen the most widely publicized inflation rate, the consumer price
index. Not all of the components of the consumer price index apply to all people;
for example, a homeowner with a fixed-rate mortgage is not affected by
rising housing costs so long as the family stays put. As many economists will
emphasize, however, the knowledge of general inflation has a discomforting
impact on people even apart from those higher prices they actually pay.

6. Let’s consider two numerical examples from the period of history covered
in this book. Consider a mortgage loan entered into in 1965 with a ten-year matu-
riety. The nominal interest rate in 1965 averaged 5.81 (ERP 1994, 352); the inflation
rate (measured by the consumer price index) was 1.6 percent (ERP 1997, 370). If we
assume that inflation rate was accurately anticipated by both lenders and borrow-
ers, then the real interest rate these mortgage lenders were expecting was 4.21 per-
cent. Within three years, when the rate of inflation had accelerated to 4.2 percent,
the actual real rate of interest received by mortgage lenders was 1.61 percent. In
1969 it was 0.31 percent; in 1970 it was even lower (0.21 percent) because inflation
was 5.7 percent. Beginning in 1973 and running through 1975, the rate of inflation
was higher than the mortgage rate of interest contracted in 1965. This translated
into a negative real interest rate. The borrowers found the reduction in the real burden of their repayment of principal greater than the nominal interest rate they had to pay. The lenders lost real income on those loans.

Now let us consider a mortgage loan contracted in 1981. The nominal rate of interest for a ten-year mortgage averaged 14.7 percent and the rate of inflation in the consumer price index was 10.3 percent. This represented a real interest rate of 4.4 percent, assuming correct anticipation by lenders and borrowers. The rate of inflation deceleration after 1981 was so dramatic that the real burden of the mortgage interest rate rose in 1982 to 8.5 percent and only once fell below 10 percent for the rest of the time till maturity. In other words, borrowers were faced with a real interest burden more than twice as great as they anticipated when they contracted the loan.

7. Some businesses can set their prices and stick to them because they have few competitors, who will most likely match their price rather than provoke a price war. In the most general sense, the distinction needs to be made between businesses that are “price takers” and those that are “price makers.” The earliest empirical work on the significant ability of certain firms to control prices was by Gardner C. Means. He identified industries that responded to the falloff in demand during the Great Depression by keeping prices relatively stable and reducing output. These industries he characterized as those with administered prices (that is, they were price makers) as opposed to those industries (such as agriculture) in which prices fell dramatically but output did not (in other words, price takers) (Industrial Prices and Their Relative Inflexibility, Senate Document No. 13, 74th Congress [Washington, DC: Government Printing Office, 1935]). This analysis was in opposition to traditional economic theory, which was built on the idea that most businesses (and sellers of factors of production) are price takers because they are subject to competition with a large number of competitors that sell roughly identical products (in the textbooks, the definition of this type of competition is even more restricted: they are all selling indistinguishable standardized products, like Class A corn, for example, or shares in AT&T). Beginning in the early twentieth century, economists began to recognize the significance of imperfectly competitive markets. Most textbooks now acknowledge the existence of competition among such a small number of firms that they are able to set prices. The technical term for this market structure is oligopoly. John Kenneth Galbraith referred to this sector of the economy as the “planning system” to identify the ability of these firms to plan output and control prices (John K. Galbraith, The New Industrial State [Boston: Houghton Mifflin, 1967], and Economics and the Public Purpose [Boston: Houghton Mifflin, 1973]). In one strand of the radical tradition, what Galbraith calls the planning system is called the “monopoly sector” of the economy, and the entire economy is identified as monopoly capitalism (see, for example, Paul Baran and Paul Sweezy, Monopoly Capital [New York: Monthly Review Press, 1966]; and John B. Foster, The Theory of Monopoly Capital [New York: Monthly Review Press, 1989]).

8. This would amount to a tax rate on my real income of 72 percent.

9. In actual experience, inflation induces most taxpayers to avoid taxable interest income. Instead, potentially taxable interest-bearing securities are bought by pension funds and other tax-exempt organizations and insurance companies and banks with very low effective tax rates. Individuals who wish the security of interest income buy tax-exempt bonds issues by states and municipalities. See

10. Paying interest of $10,000 a year on a $100,000 loan with 5 percent inflation means the real burden of repayment is only $5,000 per year.

11. This would represent fully 72 percent of the real cost of my interest payments. Tax expert C. Eugene Steuerle argues that the interaction of inflation and the ability to deduct the full nominal interest paid induces unproductive investment activity, for example, excess construction of residences, office buildings, and shopping malls, just for the purposes of reaping the tax advantages. See *Taxes, Loans, and Inflation*, 57–114.

12. Let us assume a 36 percent tax rate. With no inflation, the tax of $36,000 is 36 percent of that real gain. Now let us assume inflation over five years causes an average increase in prices of 25 percent. The $100,000 gain is only $75,000 in increased purchasing power because $25,000 merely makes up for the inflation. But the tax burden is still $36,000, only it now represents 48 percent of the ($75,000) real gain.

13. To return to our specific numerical example, with a 50 percent exclusion and a 25 percent cumulative inflation over the five years, the real gain is $75,000, and the tax rate of 36 percent is applied to only $50,000. Thus, the tax is $18,000, which is only 24 percent of $75,000. If the real gain were only $50,000, applying the tax rate of 36 percent to half the dollar gain ($100,000) produces $18,000 in taxes, which is 36 percent of the real gain.

14. See chap. 1, n. 6, which quotes the Employment Act of 1946.

15. Fiscal policy is defined as all governmental decisions involving taxation and spending. Monetary policy consists of actions of the Federal Reserve System (often merely referred to as “the Fed”) to change the rate of growth of money and/or to change interest rates. As mentioned above (chap. 1, n. 9), the United States has an independent Central Bank. The seven governors of the Federal Reserve Board are appointed by the president for fourteen-year terms to protect their independence. An expansionary fiscal policy would involve increased spending or decreased taxation or some combination of both. A restrictive fiscal policy would involve decreased spending or increased taxation or some combination of both. (For a variety of reasons, most economists believe that balanced increases of spending and taxation are expansionary and balanced decreases are restrictive, but that is quite controversial; see pp. 47–48 and chap. 3, n. 43.) An expansionary monetary policy increases the rate of growth of the money supply, aiming for a reduction in interest rates. A restrictive monetary policy decreases the rate of growth of the money supply, perhaps even contracting it, aiming for an increase in interest rates. How the alteration in money growth affects interest rates and the economy at large is the subject of a great deal of controversy. For an accessible and accurate summary of what he calls the monetary hydraulics, see Greider, *Secrets of the Temple*, 31–33. For a reasonable introduction to the controversy over how monetary policy works or does not work, see Richard Gill, *Great Debates in Economics* (Pacific Palisades, CA: Goodyear, 1976), 353–62.

were major proposals for liberalizing depreciation deductions for businesses. For details of some proposals, see ERP 1981, 76.


18. On this issue, see *Contract with America*, 125–41; *Restoring the Dream*, 37–52. On p. 41, the latter book has a diagram headlined “As Washington Grows, the Economy Slows.” In the diagram the percentage of the economy covered by government spending is set against the rate of growth of real gross domestic product. Table N-2 reproduces the numbers in table form. Despite the rise in the rate of growth of GDP in the third period even as government spending rose, the long-run trend is obviously an inverse one.


22. In 1993, economic historian Douglass C. North won the Nobel Prize in economic science for his work on how institutions interact with economic actors to make it easier or harder for economic growth to occur. One can see the proposals in the Contract with America relating to increased spending on police and prisons, increased sentences for violent criminals, and legal reform to reduce the costs to business and individuals from “frivolous” lawsuits as an effort to re-create what Republicans see is an appropriate framework within which such a market economy can function (*Contract with America*, 37–64, 143–55).


24. The *Contract with America* devotes an entire chapter to the proposition that the Clinton administration budget cuts have weakened the defense establishment to the point where the so-called hollow military of the late 1970s is in danger of being re-created (*Contract with America*, 91–113). The sequel volume, *Restoring the Dream*, 115–18, has proposed significant privatization of federally run activities such as the Naval Petroleum Reserve, the Air Traffic Control System, and certain Amtrak routes.

25. In the 1990s, there is an effort to take this principle even further. Areas of activity previously the sole responsibility of government, such as the running of prisons, have been proposed for privatization. Private companies contract with a state government to house a certain number of prisoners, getting paid a fixed fee and making their profit by delivering the “service” to the taxpayers at a lower cost than if the state paid the costs directly. With prison building on a dramatic upsurge in the past decade and prison populations rising dramatically, this is a great new frontier for profitable activity on the part of the private sector.
27. Given the incomes of all consumers, given the tastes and preference of these consumers, and given the capital and land and skills of the labor force available to be used by businesses as well as the state of technology, the satisfaction achieved by each and every consumer that is greater than or equal to the price they actually pay for what they buy exactly equals the sacrifice society has had to endure to produce the last unit of the product sold. If this occurs in every market, then this maximizes satisfaction for society as a whole. The problem of externalities is that the price paid by people does not equal the true cost to society; the satisfaction experienced by an individual does not equal the true benefit to all of society.
28. Economists would make the comparison by summing the present value of all expected net earnings of the farmer for the rest of his or her productive life. This would create what is called the capitalized value of the farmer’s income stream. In reality, such a calculation would be very uncertain, because it actually depends on how one thousand dollars, say, five years from now is discounted to create its present value. In addition, farmers may place some kind of premium on maintaining their way of life, even if the dollar value of a lifetime in farming is lower than what could be obtained by selling out to a developer. Finally, the farmer’s time horizon may include the projected incomes of his or her children and grandchildren.
29. Murray Weidenbaum, The Future of Government Regulation (New York: Anacom, 1979), 23. It should be noted that the Weidenbaum approach is not without its critics. Some have argued that his cost estimates are too high. See, for example, John E. Schwarz, America’s Hidden Success: A Reassessment of Public Policy from Kennedy to Reagan (New York: Norton, 1988), 91–98. Others have attempted to measure benefits to show that the benefits do justify the costs. See, for example, Mark Green and Norman Waitzman, Business War on the Law: An Analysis of the Benefits of Federal Health and Safety Enforcement, preface by Ralph Nader, 2d ed. (Washington, DC: Corporate Accountability Research Group, 1981). However, it is not our intention to argue these points. It is important to develop the full conservative diagnosis of what ailed the economy because the solutions proposed and attempted by both the Reagan administration and the Republican majority in Congress since 1994 aims to change public policy to meet these alleged problems.
30. Monetarists believe that the rate of growth in the money supply is the cru-
cial determinant of the rate of growth of nominal GDP, that is, GDP uncorrected for inflation. They argue that deviations of the rate of growth of money from the current trend have a direct impact on GDP, but only after a lag of uncertain length. (They also believe that the actual division of the impact between price increases and output increases is unpredictable in the short run.) Therefore, the monetarists have argued against using discretionary changes in monetary policy to combat too much unemployment or inflation. To do so would just as likely be destabilizing as not. For a detailed monetarist historical overview, see Milton Friedman and Anna Schwartz, *A Monetary History of the United States, 1867–1960* (Princeton, NJ: Princeton University Press, 1963). See also Milton Friedman, “The Role of Monetary Policy,” *American Economic Review* 58 (March 1968): 1–17.


33. Ibid., chap. 5.

34. For some examples of some of the nonsense and their common-sense refutations, see Eisner, *The Misunderstood Economy*, 99–103. This is not to say that there are not some potentially negative consequences should deficits and debt rise as a percentage of GDP. When that happens, the increased percentage of government revenues devoted to paying interest would reduce the ability of government to spend on other needed activities. However, most of the claims about the evils of deficit spending and the national debt focus on the “necessity” of reducing deficits to zero and “paying off” the debt. See, for example, virtually any speech by any member of Congress beginning in March 1995.


36. Table N-3 presents the unemployment rate and inflation rate between 1951 and 1969.


39. Within the economics profession, this view became the basis of a whole new school. Known under the general rubric of “new classical” economics, it also goes by the name of the “rational expectations” school. Very briefly, this group of economists believes that the general economy tends to an equilibrium solution and that government efforts to alter, say, the rate of growth of the economy or the level of unemployment can only have short-run impacts because in the long run, other actors in the economy will take corrective action in response to government initiatives and the economy will end up back at the same equilibrium. Thus, they strongly support the view that there is an equilibrium (“natural”) rate of unemployment toward which the economy is always tending. For a fascinating and readable analysis of this school, see Arjo Klamer, *Conversations with Economists* (Totowa, NJ: Rowman and Allanheld, 1984), 1–94. For criticism, see pp. 98–169.
### TABLE N-3. A Phillips Curve for the United States, 1951–69

<table>
<thead>
<tr>
<th>Year</th>
<th>Rate of Inflation (CPI)</th>
<th>Civilian Unemployment Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951</td>
<td>7.9</td>
<td>3.3</td>
</tr>
<tr>
<td>1952</td>
<td>1.9</td>
<td>3.0</td>
</tr>
<tr>
<td>1953</td>
<td>0.8</td>
<td>2.9</td>
</tr>
<tr>
<td>1954</td>
<td>0.7</td>
<td>5.5</td>
</tr>
<tr>
<td>1955</td>
<td>-0.4</td>
<td>4.4</td>
</tr>
<tr>
<td>1956</td>
<td>1.5</td>
<td>4.1</td>
</tr>
<tr>
<td>1957</td>
<td>3.3</td>
<td>4.3</td>
</tr>
<tr>
<td>1958</td>
<td>2.8</td>
<td>6.8</td>
</tr>
<tr>
<td>1959</td>
<td>0.7</td>
<td>5.5</td>
</tr>
<tr>
<td>1960</td>
<td>1.7</td>
<td>5.5</td>
</tr>
<tr>
<td>1961</td>
<td>1.0</td>
<td>6.7</td>
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<tr>
<td>1962</td>
<td>1.0</td>
<td>5.5</td>
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<tr>
<td>1963</td>
<td>1.3</td>
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<td>1964</td>
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<td>1968</td>
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<td>3.6</td>
</tr>
<tr>
<td>1969</td>
<td>5.5</td>
<td>3.5</td>
</tr>
</tbody>
</table>


### TABLE N-4. No Simple Phillips Curve

<table>
<thead>
<tr>
<th>Year</th>
<th>Rate of Inflation (CPI)</th>
<th>Civilian Unemployment Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>5.7</td>
<td>4.9</td>
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<tr>
<td>1971</td>
<td>4.4</td>
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<td>1973</td>
<td>6.2</td>
<td>4.9</td>
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<tr>
<td>1974</td>
<td>11.0</td>
<td>5.6</td>
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<tr>
<td>1975</td>
<td>9.1</td>
<td>8.5</td>
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<tr>
<td>1976</td>
<td>5.8</td>
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<td>1977</td>
<td>6.5</td>
<td>7.1</td>
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<td>1978</td>
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<td>6.1</td>
</tr>
<tr>
<td>1979</td>
<td>11.3</td>
<td>5.8</td>
</tr>
</tbody>
</table>


40. This may seem contradictory, but it is not. One’s marginal rate of taxation can rise even if the total percentage of one’s income paid in taxes stays the same. Consider someone with an income of $50,000 paying one rate of 10 percent in income tax. That person’s total tax is $5,000 and the marginal rate of taxation is 10 percent. Now, let us change the tax system into a two-bracket system with rates of zero percent on the first $25,000 of income and 20 percent on the second $25,000. Total taxes will still be 10 percent of income (20 percent times $25,000 = $5,000), but the marginal tax rate will have doubled. Beginning in 1964, there were a number of tax cuts that by raising personal exemptions and cutting tax rates other than the top marginal rate ended up keeping the average tax bite from rising while the marginal rate did rise.

41. It is important to understand that the tax rates shown in table 4 do not apply to the entire income of the taxpayer. Thus, someone making $25,000 in taxable income in 1980 would not owe $8,000 (32 percent of $25,000) on April 15, 1981. Instead, this person’s income tax would be the sum of the tax owed on each level of income. The first $3,400 would be tax free. The next $2,100 would be taxed at 14 percent ($294). The next $2,100 would be taxed at 16 percent ($336). Subjecting the next $17,400 to tax rates of 18, 21, 24, 28, and finally 32 percent leads to a total tax bill of $4,633. The important incentive effect of the marginal tax rate is that the extra income an individual receives as a result of making an extra effort (to take a second job, to take a higher-paying job, to make a new investment) is equal to the increase in income less the marginal tax rate. If our imaginary taxpayer with an income of $25,000 got a pay raise of $4,000, he or she would get to keep only $2,720, paying $1,280 (32 percent of $4,000) more in income tax.

42. ERP 1982, table 5-4, p. 120.

43. Assume the government raises taxes and spending by $100 billion. All of the government’s spending goes to buying military equipment, building roads, paying government employees, doing basic scientific research, thereby raising GDP. Meanwhile, some high percentage of the money paid to the government in taxes (say, $95 billion) represents a reduction in consumption expenditures, thereby lowering the GDP. But the other $5 billion in taxes paid is money that would not have been spent anyway. Thus, there is a net increase in spending of $5 billion, and that increase then is subject to the multiplier process as it ripples through the economy.

44. ERP 1982, 34–35.

45. ERP 1982, 35.

46. See, for example, Warren Shore, Social Security, the Fraud in Your Future (New York: Macmillan, 1975).

47. In 1979, 58.9 percent of the elderly would have been in poverty had they not received Social Security, unemployment compensation, and other cash payments also available universally. The other 41.1 percent with private-sector incomes above the poverty level also received Social Security. See Sheldon Danziger and Daniel Weinberg, “The Historical Record: Trends in Family Income, Inequality, and Poverty,” in Confronting Poverty: Prescriptions for Change, ed. Sheldon Danziger, Gary Sandefur, and Daniel Weinberg (Cambridge: Harvard University Press, 1994), 46.
48. Though in the case of a millionaire, the unemployment compensation and Social Security check would (today) be subject to income taxation.


**Chapter 4**


5. The government deficit as a percentage of GDP rose from less than 0.5 percent in 1974 to 3.4 percent in 1975 and 4.3 percent in 1976 (*ERP* 1997, 389).

6. The key barometer of Federal Reserve policy is the short-term interest rate that banks charge each other for overnight loans, the Federal Funds rate. In 1974, that rate had risen to 10.50. In 1975, the Central Bank pursued a vigorous policy to cut that rate down to 5.82, and the rate continued to fall till the first quarter of 1977 (*ERP* 1997, 382–83). See table W-1 on this book’s web page, <mars.wnec.edu/~econ/surrender>.

7. The GDP deflator inflation rate was 5.6 percent in 1976 and rose to 9.2 percent in 1980 (*ERP* 1997, 306). The consumer price index rose at a rate of 5.8 per-
cent in 1976 to 13.5 percent in 1980 (ERP 1997, 369). See also the inflation rates in table N-4.

8. ERP 1981, 8.

9. For the budget deficit percentages, see ERP 1997, 389 (these are fiscal years). For the recession, see chap. 2, n. 21.

10. See ERP 1981, 156–58, for an explanation of the direction of fiscal policy during 1980. It is well known that Richard Nixon always believed that the Eisenhower administration’s budget surplus in 1960 and subsequent recession was the chief cause of his narrow defeat by John F. Kennedy. Too late for Nixon, the Eisenhower administration permitted the budget to move into deficit in fiscal 1961 (0.6 percent of GDP), and the Kennedy administration raised that deficit in fiscal 1962 (1.3 percent of GDP) with the enactment of the investment tax credit combined with a five-billion-dollar increase in defense purchases. We already have seen how the Ford administration dealt with the recession of 1975. In 1970 and 1971 the Nixon administration took a number of small steps to raise the amount of fiscal stimulus. (Federal deficits rose to 2.1 percent of GDP in fiscal 1971 and stayed at 2.0 percent of GDP in 1972 [ERP 1997, 389].)

11. ERP 1997, 346. See also table N-4.


13. This point of view is summarized by President Carter himself in his report (ERP 1981, 3–5).

14. In 1981, the Brookings Institution’s academic journal put out a special issue on the productivity slowdown. In the editors’ summary, William Brainard and George Perry noted that the causes of this phenomenon “have remained largely a mystery. In the most comprehensive study to date, Edward Denison examined seventeen alternative hypotheses and concluded that alone or in combination they could explain no more than a fraction of the slowdown” (Brookings Papers on Economic Activity 1 [1981]: vii). See also Edward Denison, Accounting for Slower Growth (Washington, DC: The Brookings Institute, 1979). Interestingly, with much more hindsight, a team of economists under the direction of William Baumol of Princeton University discovered that the slowdown in productivity of the 1970s and 1980s was actually a return to the century-long trend that had been disturbed first by a tremendous decline in growth due to the depression of the 1930s and then a tremendous increase in growth in the period between 1945 and 1972. See Jeffrey G. Williamson, “Productivity and American Leadership: A Review Article,” Journal of Economic Literature 29 (March 1991): 51–68.


16. In the case of automobiles, the massive government subsidies to highway construction made automobile transportation of goods and people relatively attractive compared to rail travel and transport. There was also tremendous subsidy to housing dispersal into the suburbs with low-interest loans and tax deductions associated with home ownership. The aerospace and telecommunications industries’ dependence on government seed money and extensive research and development funds is almost self-evident. Large government purchases often become the basis of concerted business efforts to cut the cost of new technological advances. One particularly significant example is noted by the Economist.
In 1961 . . . Fairchild and Texas Instruments found themselves sitting on a clever new invention, called the integrated circuit, which nobody could afford to buy. Then, the chips cost around $120 each. By 1971, the average price was less than $42. Why the change? Mainly because President Kennedy decided to send an American to the moon—a feat which led the federal government to buy more than a million integrated circuits and taught the semiconductor industry to build them at a fraction of the initial cost. ("Will Star Wars Reward or Retard Science?" *Economist*, September 7, 1985, 96.)

The Internet is only the latest government-created product that is now available virtually free of charge for use by the private sector.

17. The stagnation school is associated with the work of Paul Baran and Paul Sweezy in *Monopoly Capital*. The basic conclusion of this school is that capitalism in the twentieth century is subject to a permanent tendency for aggregate demand to fall short of potential GDP. The result is that more and more government intervention is necessary to stave off economic depressions, and even with such intervention, a tendency toward secular stagnation sets in.

This school explains the post–World War II sustained growth by stating that the massive expansion of the military during World War II had ended the depression. Then there was a short postwar consumer boom as people made up for hard times since the early 1930s. The years 1950–53 saw the Korean War, and even with the end of the war demand hardly slackened because the economy was into the suburbanization-automobilization that by the mid-sixties had put almost two cars in every garage and built thousands of miles of interstate highways. By the end of the 1960s, another shooting war was going on, and the economy actually pushed unemployment below the 4 percent level. With the slowdown in military spending associated with the reduction in U.S. activities in Indochina came the sluggishness of the 1970s. This was counteracted with other kinds of government spending and the creation of mountains of consumer and corporate debt, but it was not enough. The economy slipped into stagnation, and the efforts to fight it only created inflation to go along with the basic problem. For this school, the economy is successful only so long as special events, usually military spending or wars, are countering the basic tendency of the economy to settle into stagnation.

18. The various writers in this tradition have presented different version of this post–World War II structure (see, for example, Bowles, Gordon, and Weisskopf, *After the Wasteland*, 48). The text presentation is my own version based on a reading from a variety of sources as well as discussions within the Center for Popular Economics on the postwar period. The main difference between this group and the Baran-Sweezy stagnation school is that the latter sees the economy as always in danger of falling into a stagnant or worse situation absent extraordinary surges in aggregate demand. The long-swing group suggests that when a coherent structure, a social structure of accumulation, is in place, the economy generates a fairly long period of decent growth with short, mild interruptions.


20. In 1953, an American CIA operative led a joint British-American effort to overthrow the elected Iranian government, which had moved to nationalize international oil companies. That government was replaced by a monarchy headed by the shah. In 1954, the elected government of Guatemala had attempted to nation-
alize some of the land owned by the United Fruit Company. Under cover of protec-
ting the hemisphere from Communist influence (the Guatemalans had bought
some military equipment from Czechoslovakia), the United States again organized
a coup (Bowles, Gordon, and Weisskopf, After the Wasteland, 50–51). See also Kermit
Roosevelt, Countercoup: The Struggle for the Control of Iran (New York:
McGraw-Hill, 1979); and Steven Schlesinger and Steven Kinzer, Bitter Fruit (Gar-
den City, NY: Doubleday, 1982).

21. The stagnation school, by contrast, believes that the economy had just run
out of causes for surges in aggregate demand, and so the natural tendency to stagn-
ation reasserted itself.

22. Arthur Okun, Prices and Quantities: A Macroeconomic Analysis (Washin-
inflationary bias that collective bargaining may add to the process.

23. Gary Byner, president, Local 1112, United Auto Workers, qtd. in Studs

Chapter 5

1. The rate of increase in the GDP deflator had averaged 6.3 percent in 1977
and 7.7 percent in 1978. In 1979, the first three quarters saw the annual rate of
inflation rise to 8.6 percent and stay at 8.7 percent for the next two (ERP 1997, 306).
Quarterly rates from Bureau of Economic Analysis, Department of Commerce.

2. ERP 1997, 422.

3. The best measure of the international value of the dollar compared to our
major trading partners actually rose slightly between 1973 and 1976 before begin-
ning to plummet (ERP 1997, 422).

4. The price of gold is per troy ounce. The monthly series for the price of
gold is published by Metals Week and available from the Branch of Metals, U.S.
Bureau of Mines.

5. The printout of monthly gold prices from the U.S. Bureau of Mines has
the highest, lowest, and average price of a troy ounce of gold per month beginning
in 1968 and continuing up to the present. Robert Bartley, quoting Roy W. Jastram,
noted that “when one nation shows economic and political turbulence, its currency
will decline as holders seek safe havens in other currencies. ‘But what happens
when danger is sensed in every direction? There is one “currency” with no indige-
nous difficulties—gold. The cautionary demand for it is really a short position
against all national currencies’” (Bartley, The Seven Fat Years and How to Do It
Again [New York: Free Press, 1992], 109). Meanwhile, the Monthly Review, oper-
ating in the radical tradition, published an editorial identifying the spike in the
price of gold as “Capitalism’s Fever Chart” (“Gold Mania: Capitalism’s Fever


8. Greider, Secrets of the Temple, 109–23. Interestingly, in other analyses of
the Fed’s policy reversal, much emphasis is placed on Volcker’s trip to an interna-
tional bankers’ conference in Belgrade, Yugoslavia, which occurred after the deci-
sion of the Board of Governors but before the ratification of that decision by the
Federal Open Market Committee. This has led some commentators to suggest that

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Volcker was responding to pressure from foreign central bankers, which of course was not true, since the decision had already been made. See, for example, Bartley, *The Seven Fat Years*, 85–86 and Blinder, *Economic Policy and the Great Stagflation*, 77.


11. Actually, these yearly figures mask some significant variations during the year. In 1980, in particular, the rate of growth of money started out at 6.7 percent (last quarter of 1979 to first quarter of 1980) but then turned negative as the economy experienced a sharp but very short (one-quarter) recession (the rate was −3.4 percent). The shrinkage of the money supply was not, of course, what the Federal Reserve had promised when it adopted monetarism. In response, the Fed shifted to an expansionary monetary policy. The rate of growth of money shot up to 15 percent in the third quarter before subsiding to 10.9 percent in the fourth. By the first quarter of 1981, the rate of growth had fallen further to 4.6 percent. Data of the Federal Funds rate and the money supply (M1) available directly from the Board of Governors of the Federal Reserve System.


13. *ERP* 1994, 347. This is evidence for the charge by Greider and others that the so-called monetarist experiment was merely a political cover for interest rates high enough to wring inflation out of the economy no matter how much unemployment would be necessary. Interest rates rose high enough to get the job done, and it didn’t matter whether the growth rate of M2 or M3 slowed.

14. Beginning at 13.82 percent in January 1980, it rose to 17.61 percent in April, then fell to 9.03 percent in July (the second quarter was the time when there was a short but sharp recession), before rising to a peak of 19.08 percent in January 1981. Over the next two months it fell to 14.70 percent before rising to 19.1 percent in June. Monthly averages for the Federal Funds rate are available from the Federal Reserve Board, table J1–1. For a quarterly time series of the Federal Funds rate, see table W-1 at the web site.

15. Federal Reserve Board, table J1–1.


18. *ERP* 1984, 299. The prime rate is the interest rate banks charge their best business customers. The mortgage rate listed here is for a conventional mortgage with a ten-year repayment period.

19. The “true” real interest rate must somehow create a measure of the expected rate of inflation that the “average” borrower and lender have agreed
upon when making the “average” loan agreement. There are a number of conventions that have been established to measure the expected rate of inflation. One of the simplest is to take the average of the preceding three years and assume that that is what borrowers and lenders expect inflation to be in the coming year(s). I have created such a table using the average inflation rate in the preceding twelve quarters for the “expected” rate of inflation in each quarter. In effect this attempts to measure what borrowers and lenders believe to be the real interest rate upon which they are agreeing. One might think of this as the planned real interest rate. To measure the actual impact on the economy of the real interest rate, I believe it is useful to concentrate on the actual burden of interest in terms of lost purchasing power. Thus, I also measure the real interest rates by subtracting the actual inflation rate in each quarter from the nominal interest rate. One might think of this as the experienced real interest rate. The inflation rate used in the appendix and throughout this book when identifying the real interest rate is the rate of increase in the GDP implicit price deflator unless otherwise noted. I choose this over the better-known consumer price index because we are looking for the generalized impact of inflation on interest rates throughout the entire economy, not just on consumers. It should be noted that no matter which way we attempt to measure real interest rates, there will always be limitations. Every individual experiences inflation differently because each person buys different types of products and “sells” different types of products, all of whose prices are changing at different rates than the average, no matter how that average is measured.

Both versions of the real interest rate peaked in 1981, fell during the recession, and then rose in 1984 as the Fed demonstrated its commitment to keeping inflation in check long before unemployment got anywhere near the 1980s version of the “natural” rate—6 percent. See tables W-2 and W-3 at the web site for details, <mars.wnec.edu/~econ/surrender>.


21. A supply curve plots alternative prices against the quantities of the good or service businesses are willing and able to provide based on the scarcity of the resources involved. If the true scarcity of all resources used in a production process, including some, such as air and water, that aren’t bought by the producers, is accurately reflected in the costs to the businesses, we can say that the supply curve accurately measures the sacrifice made by society in producing the various quantities of that product. The demand curve plots alternative prices against the quantities of a good or service consumers are willing and able to purchase. If the true satisfaction derived by the consumer is accurately reflected in the price he/she is willing and able to pay, and if there are no spillover costs and/or benefits to non-involved consumers, then we can say that the demand curve accurately measures the satisfaction experienced by society in consuming the various quantities of that product. Note that the “ifs” about true scarcities and absence of externalities conceal a whole host of exceptions, as even the Reagan administration’s first Council of Economic Advisers acknowledged (see pp. 39–41). For supply-and-demand curves, see any textbook on the principles of economics. For example, Mankiw, *Principles of Economics*, chap. 4, and Stiglitz, *Economics*, chap. 4, devote entire chapters to introducing these concepts.

22. A minimum wage does not permit the price to fall to its equilibrium. This deprives some of the “suppliers” (in this case workers) of the opportunity to offer
their labor for sale at a wage they would be willing to accept. It also deprives some “consumers” (in this case businesses seeking to hire workers) of the ability to purchase some wage-labor at a wage they would be willing to pay. The result is an artificial reduction in the amount of labor hired and, therefore, a reduction in output. This was the major argument developed by the members of Congress, such as Majority Leader Richard Armey, himself a Ph.D. economist, against the recent increase in the minimum wage.

Table N-5 is an imagined table of alternative wages and quantities of labor offered for sale restaurants by workers and desired to be hired by businesses (the “quantity” is measured in person-hours per week). Let us assume this labor market refers to fast-food restaurants, a typical job for low-wage workers. If the minimum wage were to be set at $5.50 per hour or higher, a significant number of individuals will attempt to find work and will either be hired for fewer hours than they want or will not be hired at all. Only at the “market wage” of $5.00 an hour in this imaginary example will all workers who want to work at that wage find work. Raising that wage to $6.00 per hour would cause businesses to cut back hiring from six hundred hours a week to five hundred hours, thereby causing some people to lose their jobs. For two textbook treatments of the minimum wage, see Mankiw, Principles of Economics, 118–20, and Stiglitz, Economics, 828, 833.

23. Greider, Secrets of the Temple, 177.
24. Bartley, The Seven Fat Years, 224.
27. ERP 1982, 23.
32. ERP 1982, 141.
33. ERP 1982, 142.
35. To take a fairly extreme example, the Birmingham, Alabama, fire department didn’t hire its first black firefighter until 1968. A seven-year lawsuit between 1974 and 1981 finally ended with the city entering a consent decree (like a plea bargain in a civil lawsuit). To remedy the effects of past discrimination, the city agreed that if any black candidates for either appointment or promotion were qualified, all hiring and promotion would have to be split fifty-fifty between whites and blacks.

In 1983, two firefighters took the exam for lieutenant. Both passed. Under the consent decree the black firefighter got the promotion. The problem was that though both passed the exam, the white firefighter got the higher score. Right here we see one of the cores to the battle over affirmative action. By the standards of the
job, both men were qualified. According to the supporters of the white firefighter, the scores on the test showed who was more qualified. The fact that there had been previous discrimination was irrelevant to the alleged injustice done to the white individual involved. From the other point of view, once the individuals involved are judged capable of doing the job, basic fairness involves permitting black candidates for jobs and/or promotion to be compensated for the disadvantages illegally imposed on people like them in the past. People who have higher test scores today are building on the ill-gotten gains of past discrimination (Thomas B. Edsall and Mary D. Edsall, Chain Reaction: The Impact of Race, Rights, and Taxes on American Politics [New York: Norton, 1992], 125–26). There is one other extremely important issue that builds strong support for affirmative action policies, even in the 1990s. That is the view that the desire to discriminate on the basis of race and gender has not disappeared just because it has been made illegal. In order to force decision makers to behave in a nondiscriminatory manner, some program needs to be in place. The victims of current discrimination cannot rely on goodwill and/or inability to cover up discriminatory behavior to protect their rights in the job market.

36. Ibid., 188.
37. Ibid., 191.
39. Ibid., 205.
40. This is not the place to engage in a detailed debate about affirmative action. Two very significant affirmative action cases were decided by the Supreme Court in the late 1970s. For the legal issues and facts, see “Regents of the University of California v. Bakke,” Preview of United States Supreme Court Cases, October 1977 Term, No. 4 (September 26, 1977), 1–3; and “United States Steelworkers of America v. Weber,” “Kaiser Aluminum & Chemical Corp. v. Weber,” and “United States v. Weber,” Preview of United States Supreme Court Cases, October 1978 term, no. 31 (April 5, 1979), 1–3. The important issue is to understand that regardless of whether affirmative action programs are a good idea or not, having the chief civil-rights enforcement organizations in the country more concerned with fighting “reverse discrimination” against white people than with remedying the sorry state of affairs for black Americans sends a powerful message to those

### TABLE N-5. Supply and Demand for Low-Wage Labor (invented data for illustrative purposes)

<table>
<thead>
<tr>
<th>Wage Rate</th>
<th>Person-Hours Demanded per Week</th>
<th>Person-Hours Supplied per Week</th>
</tr>
</thead>
<tbody>
<tr>
<td>$6.50/hr</td>
<td>400</td>
<td>900</td>
</tr>
<tr>
<td>$6.00/hr</td>
<td>500</td>
<td>800</td>
</tr>
<tr>
<td>$5.50/hr</td>
<td>600</td>
<td>700</td>
</tr>
<tr>
<td>$5.00/hr</td>
<td>650</td>
<td>650</td>
</tr>
<tr>
<td>$4.50/hr</td>
<td>700</td>
<td>600</td>
</tr>
<tr>
<td>$4.00/hr</td>
<td>800</td>
<td>700</td>
</tr>
</tbody>
</table>
who have always resented civil-rights enforcement and the businesses who have always resented any government intrusion into how they conduct themselves.


42. ERP 1982, 163–64. See also William Niskanen, Reaganomics: An Insider’s Account of the Policies and the People (New York: Oxford University Press, 1988), 119–20. Note, however, that in this book Niskanen voices some complaints about regulatory changes that were blocked. Particularly interesting is the following comment:

In 1983, the FCC proposed to relax the “financial interest and syndication rules,” which restrict the right of the TV networks to develop original programming and to syndicate reruns. These rules in effect protect Hollywood from competition by the networks. Although this proposal was broadly supported within the administration, the “California mafia” in the White House ruled in favor of Hollywood, and the proposal was withdrawn. (120)


44. 53.6 percent in 1970, 56.7 percent in 1975, 55.7 percent in 1980 (1993 Green Book, 616).

45. See ibid., 619, for the changes in the rules. For the numerical example, see p. 621.

46. Ibid., 738.

47. Ibid., 1312–13.

48. By contrast, the percentage of individuals in poverty receiving AFDC was 42.8 percent in 1975. Three years later that percentage stood at 42.4 percent (ibid., 471, 1225).

49. Ibid., 1622.

50. Ibid., 1632.

51. Table N-6 shows the participation in the food stamp program in absolute numbers and as percentages of the total population as well as the population living in poverty between 1975 and 1991.


53. Teresa A. Coughlin, Leighton Ku, and John Holahan, Medicaid since 1980: Costs, Coverage, and the Shifting Alliance between the Federal Government and the States (Washington, DC: Urban Institute Press, 1994), 20. According to the 1993 Green Book, 1659, the per capita real dollar spending on children and AFDC adults declined from 1981 through 1984. This was at a time where other areas of Medicaid expenditure were rising in real terms, so that the overall per capita real spending rose over 9 percent.


Since 1981, the administration has proposed more cuts in Medicaid, including an extension of reduced matching payments and a requirement that states charge beneficiaries at least a nominal amount for services received. Congress has rejected most of these proposed cuts because they would shift costs to the states or reduce service to the poor.

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Note the use of the term gross national product rather than GDP. GNP differs from GDP only slightly. It adds to GDP the income Americans earn abroad and subtracts from GDP the income foreigners earn in the United States. American national income accounts shifted from GNP to GDP in 1992, so researchers who wrote before then used gross national product as their measure of total national output.


56. 1993 Green Book, 867.
57. Ibid., 836–37.
60. Ibid., 70.
61. The percentage of unemployed workers receiving compensation averaged 50 percent in 1974, 76 percent in 1975, and 67 percent in 1976, the first full year of recovery (ibid., 491).
62. The percentages in 1981 and 1983 were 41 and 44 percent respectively (ibid., 491).

### TABLE N-6. Food Stamps Utilization, 1975–91

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Food Stamp Participants (in millions)</th>
<th>Food Stamp Participation (% of total population)</th>
<th>Food Stamp Participation (% of poor population)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975</td>
<td>16.3</td>
<td>7.6</td>
<td>63.0</td>
</tr>
<tr>
<td>1976</td>
<td>17.0</td>
<td>7.9</td>
<td>68.1</td>
</tr>
<tr>
<td>1977</td>
<td>15.6</td>
<td>7.2</td>
<td>63.1</td>
</tr>
<tr>
<td>1978</td>
<td>14.4</td>
<td>6.5</td>
<td>58.8</td>
</tr>
<tr>
<td>1979</td>
<td>15.9</td>
<td>7.2</td>
<td>61.0</td>
</tr>
<tr>
<td>1980</td>
<td>19.2</td>
<td>8.4</td>
<td>65.6</td>
</tr>
<tr>
<td>1981</td>
<td>20.6</td>
<td>9.0</td>
<td>64.7</td>
</tr>
<tr>
<td>1982</td>
<td>20.4</td>
<td>8.8</td>
<td>59.3</td>
</tr>
<tr>
<td>1983</td>
<td>21.6</td>
<td>9.2</td>
<td>61.2</td>
</tr>
<tr>
<td>1984</td>
<td>20.9</td>
<td>8.8</td>
<td>62.0</td>
</tr>
<tr>
<td>1985</td>
<td>19.9</td>
<td>8.3</td>
<td>60.2</td>
</tr>
<tr>
<td>1986</td>
<td>19.4</td>
<td>8.0</td>
<td>59.9</td>
</tr>
<tr>
<td>1987</td>
<td>19.1</td>
<td>7.8</td>
<td>59.1</td>
</tr>
<tr>
<td>1988</td>
<td>18.7</td>
<td>7.6</td>
<td>58.9</td>
</tr>
<tr>
<td>1989</td>
<td>18.8</td>
<td>7.6</td>
<td>59.6</td>
</tr>
<tr>
<td>1990</td>
<td>20.0</td>
<td>8.0</td>
<td>59.6</td>
</tr>
<tr>
<td>1991</td>
<td>22.6</td>
<td>9.0</td>
<td>63.3</td>
</tr>
</tbody>
</table>

63. In addition to the explicit changes in federal government policy, there were a number of changes adopted that encouraged states to tighten eligibility. For details, see Marc Baldwin and Richard McHugh, “Unprepared for Recession: The Erosion of State Unemployment Insurance Coverage Fostered by Public Policy in the 1980s,” Briefing Paper, Economy Policy Institute, 1992, esp. 4–7.

64. See ERP 1982, 33–34, for an analysis of why government “insurance” against low or no income is necessary because private-sector insurance will always leave some group uninsured as “bad risks.”


67. 1993 Green Book, 30–35. According to estimates from 1994, the retirement trust fund of the Social Security system will begin running deficits in 2015 and will have absorbed all of the built-up surplus by the year 2036 (C. Eugene Steuerle and Jon M. Bakija, Reforming Social Security for the 21st Century [Washington, DC: Urban Institute Press, 1994], 51). These estimates change with every report from the trustees of the Social Security system. More recent reports place the year when deficits will begin earlier and the exhaustion of the surpluses significantly earlier than 2036.


69. Steuerle and Bakija, Reforming Social Security, 237.

70. For the Medicare spending, see 1996 Green Book, 133–34. For Social Security spending and total federal spending see ERP 1997, 391, 389. (Once again, these are fiscal years.)


72. For calendar years 1980–83, the actual level of intergovernmental grants was $88.7, $87.9, $83.9, $87.0. Note that this is in a context of a rising overall federal budget (ERP 1994, 365). By contrast, such grants rose in absolute terms in both 1974 and 1975 (ERP 1980, 289).


74. Ibid., 224.

75. Table N-7 shows the relationship of individual and corporate income tax receipts to gross domestic product from 1979 to 1985. Ignoring the recession years of 1981 and 1982 and the first recovery year of 1983, even in 1984 and 1985, the ratio
of income tax collections to GDP had remained a full percentage point lower than in 1978 and 1980 and one and a half percent lower than in 1979.

### Chapter 6

1. *ERP* 1997, 389. Recall (see above, pp. 23–24) that the absolute level of the budget deficit does not tell us anything about its impact on aggregate demand. For that we need to express it as a percentage of GDP.

2. As noted in note 54 to the previous chapter, the Department of Commerce switched from gross national product to gross domestic product for their measurement of total economic activity. However, the Bureau of Economic Analysis tables for the fixed-unemployment GNP have not been so transformed.

3. Data supplied by the Bureau of Economic Analysis, Government Division, Department of Commerce, calculations by Michael Webb. The calculation is based on government expenditures and revenues calculated using the rules of payments and taxation and applying those rules to the estimated GNP with 6 percent unemployment. The structural deficit so calculated continued to rise through 1985. See table W-1 at this book’s data web site, <mars.wnec.edu/~econ/surrender>.

4. Though we are here focusing on the federal deficit, it is important to note that the actual impact on aggregate demand is created by the total government deficit (or surplus). In table W-1 at the web site, a series of the total government deficit/surplus as a percentage of GDP is included along with the structural deficit as a percentage of gross national product.

5. Monthly money stock information is available from the Federal Reserve Board. See table W-1 at the web site for quarterly data on the rate of growth of M1.

6. This is not, of course, how the strong defenders of the incentive policies of the Reagan administration see it.

With the Phillips curve, the Keynesians found themselves trying to hit two birds [inflation and unemployment] with one stone. To fight

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<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>GDP (in billions of dollars)</th>
<th>Individual Income Tax Receipts</th>
<th>Corporate Income Tax Receipts</th>
<th>Total Income Tax Receipts (% of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>2,212.6</td>
<td>181.0</td>
<td>60.0</td>
<td>10.9</td>
</tr>
<tr>
<td>1979</td>
<td>2,495.9</td>
<td>217.8</td>
<td>65.7</td>
<td>11.4</td>
</tr>
<tr>
<td>1980</td>
<td>2,718.9</td>
<td>244.1</td>
<td>54.6</td>
<td>11.0</td>
</tr>
<tr>
<td>1981</td>
<td>3,049.1</td>
<td>285.9</td>
<td>61.1</td>
<td>11.4</td>
</tr>
<tr>
<td>1982</td>
<td>3,211.3</td>
<td>297.7</td>
<td>49.2</td>
<td>10.8</td>
</tr>
<tr>
<td>1983</td>
<td>3,421.9</td>
<td>288.9</td>
<td>37.0</td>
<td>9.5</td>
</tr>
<tr>
<td>1984</td>
<td>3,812.0</td>
<td>298.4</td>
<td>56.9</td>
<td>9.3</td>
</tr>
<tr>
<td>1985</td>
<td>4,102.1</td>
<td>334.5</td>
<td>61.3</td>
<td>9.7</td>
</tr>
</tbody>
</table>

*Source: ERP 1997, 389, 391.*
inflation, you needed one lever. And to fight stagflation, you need a second one... the answer was clear: You fight inflation with monetary policy... And you fight stagnation, you stimulate the economy, with incentive-directed tax cuts. (Bartley, *The Seven Fat Years*, 59)

7. I don’t want to be misunderstood. I personally believe that the pain and suffering inflicted on people during a recession is a terrible blot on our economic system. For some impressionistic details, see Greider, *Secrets of the Temple*, 450–71. The reason I choose not to belabor this issue is that from the point of view of long-run policy, the success or failure of the Reagan-Volcker program is to be judged not by the existence of the recession but by the nature of the recovery. Those are the terms on which the architects of the policy wished to be judged, and those are the terms on which history must make the judgment.

8. See Isabel V. Sawhill and Charles F. Stone, “The Economy, the Key to Success,” in Palmer and Sawhill, *The Reagan Record*, 82–90, for some simulations of how a different policy mix might have avoided the depth and severity of the recession and still brought inflation down (though not as far down as actual policy). See also Blinder, *Hard Heads, Soft Hearts*, 79.

9. For details of this point of view, see Bowles, Gordon, and Weisskopf, *After the Wasteland*, 80–96.


12. For example, in his account of the Reagan years Robert Bartley of the *Wall Street Journal* argued that the recession was caused by a failure to concentrate the supply-side incentives in the first year of the Economic Recovery Tax Act, coupled with the Federal Reserve’s inconsistent monetary policy. Bartley would have preferred a “commodity” standard to anchor the value of the dollar rather than the restrictive monetary policies of Volcker’s Fed. See Bartley, *The Seven Fat Years*, 103–33.

13. For example, despite the very low unemployment rates in 1967 and 1968, the federal deficit as a percentage of GDP only reached 2.9 percent in fiscal 1968. See *ERP* 1997, 390.

14. If we are interested in the impact of policy, the structural deficit of the federal government is important. However, if we want to observe the impact on aggregate demand, we have to observe the actual deficit of all levels of government, federal, state, and local. Thus, in table W-1 at the web site we have tracked the total government deficit as a percentage of GDP.

15. These are calculations of the after-the-fact real interest rate. The real rate generated with a series of expected rates of inflation shows a similar qualitative difference in general between the post-1983 years and the period of the 1970s, but it does experience high levels in both 1970 (averaging 3.23 percent) and 1974 (averaging 5.03 percent). The rate of growth of the money supply tells a different story. Except for 1984, the rate of growth of M1 was quite high from the abandonment of monetarism in the last quarter of 1982 through 1986. Beginning in 1987, the Fed tightened up on the rate of growth of money. What is interesting is that through most of the decade of the 1980s, the impact of the rate of growth of money on the
real interest rate and on the rate of growth of nominal GDP was hard to identify. For quarterly details, see table W-1 at the web site, <mars.wnec.edu/~econ/surrender>, for the rate of growth of M1 and the after-the-fact measure of the real interest rate. Tables W-2 and W-3 at the web site have two measures of the expectations-generated real interest rate.


17. This decision and the White House and bond market reactions are reported in Greider, *Secrets of the Temple*, 611–24.

18. (ERP 1986, 292). Note that these figures are percentages of the entire labor force and are therefore not completely comparable to the figures in table W-4 on the web site because those figures are for the civilian labor force only.


20. Ibid., 186. For GDP, see ERP 1997, 300.


22. Interestingly, Steuerle argues that part of the reason those first efforts failed was not merely that Social Security had a strong and politically potent constituency.

During 1981, the administration held some internal meetings on Social Security reform: with some political officials from the White House, the Department of Health and Human Services and the Social Security Administration. In attendance were many new political appointees with strong but sometimes unchecked views on what was wrong with the system. The newcomers were so distrustful of the entire civil service that they prevented many of the most talented individuals in the executive branch, including top analysts from the Social Security Administration, from attending these meetings. Valuable information was thereby precluded through inadequate use of staff. The controversy that surrounded the proposals that were tentatively released, therefore, was due not simply to the difficulty and sacredness of the Social Security issue; it was also due to bad planning and the forwarding of some poorly designed proposals. (*The Tax Decade*, 62)

23. This last item ultimately reduced payments by $39.4 billion between 1983 and 1989. This may seem strange because it is only a onetime delay. However, if there had been no delay, the cost-of-living increase would have been paid six months early every year after 1983 as well. Thus, the total cost of the delay to the recipients (and thus the savings to the Social Security trust funds) adds up year after year. See 1993 *Green Book*, 34. See also Steuerle, *The Tax Decade*, 62–63.


26. 1993 *Green Book*, 34. Focusing only on tax increases, not benefit changes, Steuerle comes up with the number $110.5 billion (*The Tax Decade*, 65). Steuerle’s total is approximately $20 billion lower than the 1993 *Green Book*’s figure, but since he used the 1990 *Green Book*, I assume the figure in the text to be more accurate.

27. See Steuerle, *The Tax Decade*, 49, for an example of how a 9 percent real loss on an investment could translate into a positive profit of 3 percent for a tax-
payer who borrowed the money, depreciated the asset at the accelerated post-1981 rate, and took the investment tax credit. Steuerle also notes that by 1984

“tax straddles” . . . had become too popular for the legislature to ignore anymore. A person could essentially buy and sell rights to future commodities in a way that created equal gains and losses—like flipping a coin and betting on both heads and tails. The taxpayer would then take losses on whichever “leg” of the straddle generated a loss, use that loss to offset other capital gains that otherwise would be taxable, and then defer recognition of the “leg” with a gain to future years. (67)

28. Ibid., 92.
29. Ibid., 186.
30. Ibid., 112.
31. Ibid., 122.
32. The effective rate of taxation is defined as the ratio of actual taxes paid to the broadly defined tax base (ignoring preferences for the moment). Recall that the rate of inflation changes the real value of the depreciation allowances as well as the real value of interest deductions. (See ibid., 151, for some alternative calculations at different inflation rates.) Other variations in effective tax rates have to do with whether or not the particular industry devotes most of its investment dollars to equipment purchases that would then trigger the investment tax credit.
33. Under pre-1986 law, the capital-gains exclusion would have made only forty thousand dollars taxable, in this case overcorrecting for inflation.
34. Steuerle, The Tax Decade, 145
35. Bartley, The Seven Fat Years, 157.
36. The original idea of the Tax Reform Act was to have two positive rates as well as a “zero bracket.” These rates ended up being 15 percent and 28 percent. However, to raise more revenue, at a certain level of income (seventy thousand dollars in 1987, thereafter indexed for inflation), the benefits of the zero bracket and lower rate of 15 percent were phased out at the rate of 5 percent of income over that threshold. This had the effect of raising the marginal tax rate temporarily to 33 percent until all the benefits of the zero bracket and 15 percent rate had disappeared. At that point (in 1987 at an income of $127,000, thereafter indexed) the marginal tax rate reverted to 28 percent.
37. This changed the definition of “long-term” capital gains from one year to a year and a half. Allegedly this was designed to reduce the tax advantage for purely speculative investments—to give the preference to those making some kind of a “commitment” to their investments. See “Highlights of Some Provisions Covering Taxes and Tax Credits, Capital Gains,” New York Times, July 30, 1997, A16.
39. Niskanen, Reaganomics, 125.
41. Coughlin, Ku, and Holahan, Medicaid since 1980, 104.
42. ERP 1989, 196.
43. ERP 1989, 198.
44. Contract with America, 135. See also the arguments on pp. 139–41.
45. See p. 207 and pp. 212–14 for a discussion of the Bush administration’s activities in this area.

46. In the first four months under the 1984 law, the AFDC grant would be cut 43 cents for every dollar of earnings. During the next eight months, the benefit reduction rate climbs to 63 cents out of every dollar. This is lower than the cut under OBRA, 1981, but it is still high enough to reduce the monthly cash grant in the median state to zero. After twelve months on welfare, the grant is reduced by approximately 70 cents for every dollar of earnings. Under the 1988 law, each of these rates is slightly reduced. The numbers are 36, 62, and 67 cents per dollar of benefits for the same three durations. Again, after four months the net benefits in the median state have been reduced to zero (1993 Green Book, 621).

47. Ibid., 625. See pp. 630–33 for details on which states offered which programs as of 1993. For participation requirements, see pp. 627–28.

48. Ibid., 640–44.

49. Ibid., 668.


52. Table N-8 shows the percentages for 1984 through 1990.


55. For the trend in the poverty threshold for different-sized families, see 1993 Green Book, 1310. By 1989, the three-person family needed $9,885 per year to escape from poverty, over 40 percent above the income of a year-round, full-time worker receiving minimum wage.

56. Ibid., 1630: “The across-the-board benefit increase in maximum benefits (above normal inflation adjustments) called for by the act was 0.65 percent in fiscal year 1989, 2.05 percent in fiscal year 1990, and 3 percent in later years.”

57. For data on enrollment and expenditures by eligibility groups, see Coughlin, Ku, and Holahan, Medicaid since 1980, 20–21.

58. Ibid., 35.

59. Ibid., 46–53.

60. Ibid., 58–59.

61. For details see 1993 Green Book, 261–62, especially the footnote on p. 261.


63. Medicaid was $78.2 billion in 1990. National spending on nursing-home care was $53.3, of which approximately 47 percent was paid by Medicaid (1993 Green Book, 266, 1647, and 259). Elsewhere the Green Book gives a percentage of 27 percent of Medicaid spending for fiscal 1991. This is lower than the figure in the text because it excludes nursing homes for the retarded. Whatever the percentage, the following information is quite relevant: “In 1991, Medicaid nursing home payments amounted to 60 per cent of total Medicaid payments for all services for all elderly beneficiaries” (ibid., 261).

64. For the Medicare spending, see 1996 Green Book, 134. For Social Security spending and total federal spending see ERP 1997, 391, 389.

65. This result was obtained by comparing the average annual benefit per aged person in 1980 and 1990 (1993 Green Book, 138) and deflating both numbers by the consumer price index (ERP 1995, 341). The more rapid escalation in the costs

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of Part B should not be surprising, since hospital reimbursements had been subject to a form of price controls since 1983. This result also demonstrates one of the problems health care policymakers began to discover during the 1980s: price controls in one part of the system merely encourages price to rise all that more rapidly in other parts of the system. If we deflate the average annual benefit per aged person by the consumer price index for medical care, the real benefits still have risen, but by less than 10 percent for Medicare Part A and a bit less than 80 percent for Part B. This demonstrates that the rising price of medical care was not the only reason for increased spending, that there was an increase in the real amount of services delivered. Again, the difference between Part A cost increases and Part B relates to the imposition of price controls.

66. See 1993 Green Book, 266.

67. In Restoring the Dream, 133—40, the Republican members of the House of Representatives describe how they will save Medicare from bankruptcy and offer senior citizens more choice than they now have while avoiding coercing Medicare beneficiaries “into mandatory health alliances such as those proposed in Clinton’s 1994 health-care proposal.” They do this without proposing any comprehensive health care reform, and in fact they imply that such a reform is unnecessary because “Market-based reforms have reduced the inflation rate in private-sector spending to 4.7 percent” (139). Republicans and Democrats did cooperate in passing a very modest health reform bill, the Kennedy-Kassebaum Act of 1996.

68. Robert Pear, “$24 Billion Would Be Set Aside for Medical Care for Children,” New York Times, July 30, 1997, A17. This change would permit states to extend insurance to over 2 million previously uncovered children and retain coverage to over 1 million who would have lost Medicaid coverage as a result of the welfare law changes. See O’Neill, letter to Raines, 48–50.


70. Blinder, Hard Head, Soft Hearts, 103.

71. Ibid., 221n. 41.

72. Blinder claims that this occurred because of “accounting gimmicks and budget trickery that gave the appearance of compliance with Gramm-Rudman without the reality” (ibid., 104).
73. Automatic reductions occurred only if the budget as adopted projected a deficit $10 billion above the target set by the law during the first two weeks. An incorrect projection does not trigger the automatic cuts when it is proven wrong later in the fiscal year (ERP 1990, 70; see also Blinder, *Hard Heads, Soft Hearts*, 104).

74. “[I]f the projected deficit exceeds the target by more than [$10 billion] the Administration calculates automatic spending cuts (or sequester) needed in each program to meet the . . . deficit target. If legislation does not achieve this reduction by the end of the second week of the fiscal year, the President orders a sequester” (ERP 1990, 71).

75. Whereas the 1990 report of the president’s Council of Economic Advisers described the workings of the Gramm-Rudman-Hollings Act (pp. 69–73), the 1991 report doesn’t even mention it, focusing instead on the OBRA of November, 1990 (ERP 1991, 46–49).

76. It is important to note, however, that the Reagan administration made no moves toward a more competitive international trade stance. Despite the rhetoric of conservative economics in favor of “free trade,” the administration supported the profitability of the top American industries, particularly the automobile industry, “presid[ing] over the greatest swing toward protectionism since the 1930s” (Shaﬁqul Islam, “Capitalism in Conﬂict,” Foreign Affairs 69 (1990): 174). This judgment, which is echoed by the work of Patrick Low in *Trading Free* (New York: Twentieth Century Fund, 1993), 271, 270ff., is consistent with the view that the real role for government in our kind of society is to rig the market in favor of those who already have an advantage and that the “principles” of conservative economics that we identiﬁed in chapter 3 and that we have used as yardsticks for the Reagan administration’s policy initiatives are routinely ignored whenever it serves the higher purpose of increasing the wealth and power of the already wealthy and powerful. Though I ﬁnd signiﬁcant evidence for this general point of view, I reiterate that the analysis of this book reaches a different conclusion. Whatever the motivations of policymakers and their intellectual supporters, the changes identiﬁed in the previous two chapters do constitute a qualitative shift in the role of government in the American economy. In addition, as we will see in the following chapters, despite the increase in protectionism, U.S. industry was subjected to increased international competitive pressure throughout the two Reagan terms.

Chapter 7


2. Bartley, *The Seven Fat Years*, 141–42.


5. Bartley, *The Seven Fat Years*, 140.

6. ERP 1985, 187–89. There remains a significant debate as to the long-run consequences for the actual productivity of ﬁrms that are successfully targeted for takeover. Compare Davis and Lehn, “Securities Regulation,” 131–34, with Robert

7. ERP 1989, 39. Note again the reference to gross national product rather than GDP.


10. Note this differs from the depreciation businesses are permitted to deduct from taxable income. The government-measured capital consumption allowance is based on fixed service lives for each type of capital equipment in use and is measured by deducting the total value of the investment divided by that service life every year.

11. The unemployment rate fell from 9.4 percent in the third quarter of 1983 to 7.5 percent in the second quarter of 1984 (U.S. Department of Labor, Bureau of Labor Statistics, Current Population Survey). Real GDP per capita grew at the rates of 7.9 percent, 6.1 percent, 6.3 percent, 8.1 percent, and 5.2 percent from the second quarter of 1983 through the second quarter of 1984. Investment as a percentage of GDP rose from 14.3 percent in the first quarter of 1983 to 16.6 percent in the third quarter of 1984 (U.S. Department of Commerce, Bureau of Economic Analysis). For all the quarterly numbers, see table W-4 at the web site, <mars.wnec.edu/~econ/surrender>.


13. For the quarterly Federal Funds rate, see table W-1 on the web site. Monthly rates available from the Federal Reserve Board, FFR, effective rate averages of daily figures, October 4, 1994, table J1–1 (monthly values of FFR 1964–September 1994). For the capacity utilization rate and unemployment rate, see table W-4 on the web site.


15. ERP 1996, 280–81. It is also important to note that during this period, the macroeconomic policies pursued by our major trading partners, particularly West Germany and Japan, were much less expansionary. For details, see Robert Blecker, Beyond the Twin Deficits: A Trade Strategy for the 1990s (Armonk, NY: M. E. Sharpe, 1992), 37–40, especially the table on p. 39.

16. As Benjamin Friedman writes,

The chief counterpart of our overconsumption in the 1980s has been underinvestment. On average during the prior three decades, we invested 3.3 percent of our total income in net additions to the stock of business plant and equipment . . . Thus far [1987] during the 1980s, the average has been just 2.3 percent. (Day of Reckoning: The Consequences of Economic Policy under Reagan and After [New York: Random House, 1988], 28–29).

Note, however, that this decline in net investment is not matched completely by a decline in gross investment. See table 12.


18. Friedman, Day of Reckoning, 174.

19. See table 11 for evidence as to whether or not this was in fact true.
20. “This idea of permanent or irreversible effects of a temporary exchange rate changes has become known as “hysteresis” . . . temporary but large appreciation of a nation’s currency induces foreign firms to enter the domestic market as long as they can still make a profit over their operating costs in their own currency in spite of the home currency’s depreciation. Thus the market structure of the home country is permanently altered” (Blecker, Beyond the Twin Deficits, 48). For a detailed model see Richard E. Baldwin, “Hysteresis in Import Prices: The Beachhead Effect,” American Economic Review 78 (September 1988): 773–85.


23. The Federal Funds rate averaged below 7 percent in 1986 and 1987; the rate of growth of M1 went from a low of 5.7 percent in 1984 to 12.4 percent and 17 percent in 1985 and 1986 respectively before falling back to 3.5 percent in 1987. For the Federal Funds rate see Federal Reserve Board, table J1–1, available from the Federal Reserve Board. For the rate of growth of M1 see ERP 1989, 385. The real Federal Funds rate, though remaining at a historically high rate, did fall below 3 percent for two quarters in 1986 and the first quarter of 1987.


25. In 1980, the merchandise trade deficit was 0.9 percent of GDP, while the 1992 deficit was 1.5 percent of GDP (ERP 1996, 392, 280). The full balance on current account (which is the usual statistic reported in the press as the “trade deficit”) went from surplus in 1980 to a deficit of close to 1 percent of GDP.

26. Economists say you are “receiving” an “implicit income”—the rent you do not have to pay because you own your own home. It is not as outrageous as it sounds. When you live in a house or apartment you are “consuming” the services of that structure, whether you pay rent or not.

27. Friedman, Day of Reckoning, 151.


32. Friedman, Day of Reckoning, 76.

33. Ibid., 79–80.


35. Ibid., 159.


39. “In earlier historical phases, the rise of private debt financing was checked and reversed when credit bubbles were burst by severe debt deflations and widespread defaults, which in turn forced the economy’s aggregate rate of debt financing sharply downward. In the contemporary period, cyclical deficits counteract the debt deflation process by increasing the level of aggregate income in the short run” (ibid., 133).


41. Ibid., 9.

42. Pollin, “Budget Deficits,” 133.

43. See pp. 70–72.

44. See pp. 138–39.


46. The job satisfaction index is derived from polls conducted by the Opinion Research Corporation. Bowles, Gordon, and Weisskopf counted the percentage of employees who answered the question “How do you like your job—the kind of work you do?” with either “Very much” or “A good deal” (Bowles, Gordon, and Weisskopf, *After the Wasteland*, 102).

47. This is a measure that takes the gross hourly wage of nonsupervisory workers, adds the fringe benefit of medical insurance, and subtracts Social Security and personal income taxes. See Thomas Weisskopf, “Use of Hourly Earnings Proposed to Revive Spendable Earnings Series,” *Monthly Labor Review*, November 1984, 38–43.


49. F. W. Taylor developed a system he called “scientific management” in the early years of the twentieth century. He urged business leaders to recognize that initially the workers monopolized the knowledge of the production process and, following their obvious self-interest, attempted to make the job as easy as possible for themselves. Taylor started by *studying* the processes and then attempted to force the workers to work harder. He had an extraordinarily difficult time but ultimately succeeded in the experiments he carried out. This whole process is described in great detail in Taylor’s autobiographical works. See, for example, F. M. Taylor, *The Principles of Scientific Management* (New York: Harper and Brothers, 1916), 42–52.

50. See p. 67.

51. See Bowles, Gordon, and Weisskopf, *After the Wasteland*, 126, for a particularly dramatic illustration. Union membership was above 20 percent of the workforce and had fallen to 15 percent by the end of the decade.

52. The point is, I would fear being fired from a job that paid me what I considered a good wage more than I would fear being fired from a job that paid me what I considered a very low wage. If I were in a job in which I got no raise over a
five-year period during which inflation had eroded some of my real purchasing power, my attitude toward my job would undoubtedly decline.


54. Table N-9 gives annual information on deficits, money supply growth, and inflation. As deficits fell as a percentage of GDP, the rate of growth of money (both the broader and the narrower measure) tended downward as well. In the two years when the trend was reversed (1985 and 1986) the rate of growth of money increased as well. But the rate of inflation continued to trend downward during those two years of rising deficits and rising rate of money growth, and when the deficit increase and money growth reversed themselves between 1986 and 1989, the rate of growth of inflation began to increase.

### Table N-9. Relationship between Deficits, Money Growth, and Inflation

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Government Deficit (% of GDP)</th>
<th>Rate of Growth of Money Supply (M1)</th>
<th>Rate of Growth of Money Supply (M2)</th>
<th>Inflation Rate (GDP deflator)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1983</td>
<td>4.2</td>
<td>9.9</td>
<td>12.0</td>
<td>4.2</td>
</tr>
<tr>
<td>1984</td>
<td>3.0</td>
<td>6.0</td>
<td>8.7</td>
<td>3.9</td>
</tr>
<tr>
<td>1985</td>
<td>3.2</td>
<td>12.3</td>
<td>8.3</td>
<td>3.3</td>
</tr>
<tr>
<td>1986</td>
<td>3.5</td>
<td>16.8</td>
<td>9.5</td>
<td>2.7</td>
</tr>
<tr>
<td>1987</td>
<td>2.6</td>
<td>3.5</td>
<td>3.6</td>
<td>3.1</td>
</tr>
<tr>
<td>1988</td>
<td>2.1</td>
<td>4.9</td>
<td>5.5</td>
<td>3.7</td>
</tr>
<tr>
<td>1989</td>
<td>1.7</td>
<td>1.0</td>
<td>5.0</td>
<td>4.2</td>
</tr>
<tr>
<td>1990</td>
<td>2.8</td>
<td>4.1</td>
<td>3.5</td>
<td>4.3</td>
</tr>
</tbody>
</table>


Chapter 8

1. The profit rate in the nonfarm business sector averaged 4.1 percent between 1980 and 1988, reaching 4.6 percent in 1988. This is in contrast to the 1974–79 period, when the profit rate averaged 2.42 percent and reached 2.94 percent in 1979. See Baker, “Trends in Corporate Profitability,” tables 6 and 7. The after-tax profit rate of nonfinancial corporations rose from 4.26 percent in 1974–79 to 4.75 percent in 1980–88, reaching 5.82 percent in 1988 (see ibid., tables 1 and 2).

2. Tables W-4 and W-5 at the web site, <mars.wnec.edu/~econ/surrender>, provide the quarterly data from 1960 through 1991. The raw data for table W-4 is summarized in table 12, the appendix to this chapter.

3. We should remember that in this discussion we are using the term *investment* in the same way we introduced it in chapter 2: as a real, tangible, creation of a capital asset. In the National Income and Product Accounts of the United States it is called *Gross Private Domestic Investment* and includes all construction of new structures, all new business equipment, and net additions to business inventories.
We will discuss the potential roles of purely financial investments (such as business merger activities, the buying and selling of corporate stocks and bonds) on pp. 156–57.


5. Investment as a percentage of GDP actually averaged 17.1 percent for the six quarters following the peak in the first quarter of 1980. For the next six quarters (five of which constituted the recession of 1981–82), investment as a percentage of GDP averaged 15.6.


8. Though the National Bureau of Economic Research identified the third quarter of 1973 as a peak and the third quarter of 1981 as a peak, the 1981 peak was the result of a very short and not very dynamic recovery from the equally short recession of 1980, which actually only lasted one quarter. The unemployment rate at the peak in 1973 was 4.8 percent and the capacity utilization rate 88.5 percent, while the unemployment rate at the 1981 peak was 7.4 percent and the capacity utilization rate 81.6 percent. These were hardly improvements over the trough values for 1980 of 7.7 percent unemployment and 80.0 percent of capacity utilization. Thus, a peak-to-peak comparison of 1973 to 1981 is very misleading. Either one should use the period from the peak of 1973 to the peak of 1980, or as we do in the text, take the longer periods from 1969 to 1980 or 1970 to 1982.

9. It is important at this point to recognize that these average rates of productivity growth are not the same as the compound rate of growth. Let me illustrate. If over a ten-year period, productivity grows 10 percent, the average is 1 percent per year. But the compound rate of growth is actually a bit less (0.96 percent). Thus, for any given change over a period of years, the cumulative compound rate is always lower than the average rate. If we try to compare productivity growth over different length periods of time, the longer the period, the lower the relationship between the compound rate and the average rate. So if productivity were to grow 20 percent over two years, the average would be the same as for a 10 percent growth over ten years, but the compound rate would be lower (0.92 percent). Thus, the appropriate comparison for productivity growth over different length periods of time is the average per period rather than the cumulative compound rate. This same principle applies to the rate of growth of per capita GDP.


the claim that target firms are poorly managed underperformers is not borne out by the facts. . . . Many of the takeovers, in hindsight, turned out to be bad deals. . . . There is a long catalogue of cases in which the acquiring firm . . . knew less about what it was buying than the established management, and proved to be an even worse manager. Several recent studies confirm that hostile takeovers . . . tend to depress the performance of the raiding firm. (183–84)


12. Note the previously mentioned chapter (chap. 6) in *ERP* 1985. The $100 billion figure is from p. 193.

14. ERP 1989, 7. Actually, in the statistical tables in that same report, the total number of nonagricultural jobs at the end of 1988 was only 17 million above the nadir at the end of 1982. The growth in the total number of jobs was also only 17 million (ERP 1989, 345; ERP 1986, 288). The 19 million figure in the text was based on job growth through May 1990.

15. Compare the first three rows in table N-10 with any comparable rows from the NFC or VRB periods. The table compares the average rate of productivity growth in the various periods with the average nonagricultural jobs created per quarter. In some cases, total employment peaks and troughs do not correspond to the turning points in the business cycle, but I have used those business cycle turning points as the comparative benchmarks.


17. This is the consumer price index (ERP 1994, 339). The GDP deflator rose from 2.0 percent to 5.4 percent in the same period (ERP 1997, 306).

18. Unemployment fell below 6 percent in the fourth quarter of 1987 and kept falling through 1989. See table W-4 at the web site, <mars.wnec.edu/~econ/surrender>.

19. Recall in this context the quote from Barry Bosworth cited in chap. 4, n. 3.

20. The thirty-two-quarter expansion from 1962 to 1969 is longer than the Reagan-Bush expansion of 1983–90. Nevertheless, since at least three of the earlier years coincided with the heaviest American involvement in the war in Indochina (1966–69), it is correct to call the Reagan-Bush years the longest peacetime expansion since World War II. The view that it is so important to avoid the acceleration of inflation that 5.5 percent unemployment is about the lowest the economy can sustain now permeates virtually the entire policymaking establishment. When President Clinton nominated Alan Blinder to be a governor of the Federal Reserve System, the financial markets demonstrated unease because Blinder is known as a Keynesian who sees reducing unemployment as a major priority, at least until inflation appears imminent. Meanwhile, the policy of the Federal Reserve System beginning in 1984 has been to engage in “preemptive strikes” of tight monetary policy in order to keep inflationary pressures from even appearing on the horizon. The result has been the remarkable specter of the Federal Reserve reacting to the first really prosperous year of the recovery, 1994, by attempting to stifle that recovery with seven increases in the interest rate. See Robert D. Hershey Jr., “Federal Reserve Raises Its Rates Seventh Time in a Year,” New York Times, February 2, 1995, A1, D4.

21. From the depths of the 1982 recession to the peak in 1990, the economy averaged a 2.77 percent annual growth rate per quarter in per capita GDP. This compares favorably with the period from 1971 to the peak in 1980, when the average was 2.50 percent. The 1962–69 period and 1975–80 period each had higher rates.

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23. See p. 134. Blecker, Beyond the Twin Deficits, claims three types of evidence for this conclusion.

   [The real value (purchasing power) of the dollar which would enable the United States to balance its trade has decreased steadily over time. . . . the response of U.S. exports to foreign income growth is much smaller than the response of U.S. imports to domestic income growth. . . . U.S. nonoil imports have grown by roughly $98 billion more in the past ten years [1980–90] (measured in constant 1982 dollars) than can be accounted for by changes in import prices, exchange rates, and national income. (58)

The details are provided on pp. 58–70.

24. See table W-5 at the web site, <mars.wnec.edu/~econ/surrender>.

25. For evidence that the percentage of personal income saved did not rise as a result of the alleged incentive changes in the early 1980s, see ERP 1997, 332.

26. In a study for the Economic Policy Institute, Robert Blecker decomposed the increase in consumption into a number of sources and found that 60 percent of the increase in consumption was explained by increases in interest income, wealth, cash receipts from successful business takeovers, and the rise in transfer payments.

### TABLE N-10. Job Growth and Productivity Growth, 1960–91 (in billions of dollars)

<table>
<thead>
<tr>
<th>Period</th>
<th>Rate of Growth of Productivity</th>
<th>Total Non-Agricultural Jobs Created (in thousands)</th>
<th>Average Job Creation per Quarter (in thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960 peak to 1969 peak</td>
<td>2.87</td>
<td>13,391</td>
<td>352.4</td>
</tr>
<tr>
<td>Recovery 1962–1969 peak</td>
<td>2.71</td>
<td>12,726</td>
<td>397.7</td>
</tr>
<tr>
<td>1969 peak to 1970 trough</td>
<td>2.73</td>
<td>12,680</td>
<td>352.2</td>
</tr>
<tr>
<td>1969 peak to 1980 peak</td>
<td>2.01</td>
<td>19,795</td>
<td>475.5</td>
</tr>
<tr>
<td>Recovery 1971–1980 peak</td>
<td>1.92</td>
<td>19,721</td>
<td>533.0</td>
</tr>
<tr>
<td>1971 trough to 1982 trough</td>
<td>1.56</td>
<td>19,306</td>
<td>402.2</td>
</tr>
<tr>
<td>1973 peak to 1980 peak</td>
<td>1.33</td>
<td>12,711</td>
<td>508.4</td>
</tr>
<tr>
<td>Recovery 1974–1980 peak</td>
<td>1.63</td>
<td>13,464</td>
<td>673.2</td>
</tr>
<tr>
<td>1980 peak to 1990 peak</td>
<td>1.09</td>
<td>19,222</td>
<td>457.7</td>
</tr>
<tr>
<td>Recovery 1983–1990 peak</td>
<td>1.35</td>
<td>18,662</td>
<td>602.0</td>
</tr>
<tr>
<td>1982 trough–1991 trough</td>
<td>1.23</td>
<td>17,396</td>
<td>527.2</td>
</tr>
</tbody>
</table>

Source: Column 1: see table W-4 at the web site, <mars.wnec.edu/~econ/surrender>; column 2: Bureau of Labor Statistics.
Except for the rise in transfer payments, virtually all of the rest of the increases accrue to high-income individuals. See Are Americans on a Consumption Binge? The Evidence Reconsidered (Washington, DC: Economic Policy Institute, 1990), 27.

27. See table W-1 at the web site, <mars.wnec.edu/~econ/surrender>; column 2 gives the total government deficit beginning in 1970. For the federal deficit in fiscal years, see ERP 1997, 390.

28. This is another form of the mainstream argument against supply-side or “incentive-based” economics. The key to the incentive of private investors is to be found in overall aggregate demand and growth in the economy, not in the tax rate on profits or the burden of government regulation. See pp. 51–52.

29. See ERP 1997, 382, for annual values for both the prime rate and the Federal Funds rate.

30. In column 2 we measure the real rate after the fact by subtracting the prime rate from that year’s rate of increase in the GDP deflator. In column 3 we follow convention by taking each year’s expected rate of increase in the GDP deflator as an average of the three previous year’s rate of increase in that variable.

31. In a detailed summary article of many of the issues related to the crowding-out controversy, economists from the Treasury Department and the Congressional Budget Office analyzed forty-two separate studies of the relationship between federal deficits and interest rates. Seventeen showed that federal deficits caused interest rates to rise, nineteen showed that they either had no statistically discernible impact or caused interest rates to fall, while six produced “mixed” results (James R. Barth, George Iden, Frank S. Russek and Mark Wohar, “The Effects of Federal Budget Deficits on Interest Rates and the Composition of Domestic Output,” in The Great Fiscal Experiment, ed. Rudolph G. Penner [Washington, DC: Urban Institute Press, 1991], 71–141; for the table see pp. 98–102). Note, however, that the appropriate crowding-out impact can only be measured against the total government deficit because if state surpluses counteract federal deficits, the credit markets are not drained as much as a focus on the federal deficit would indicate.

32. See, for example, Bartley:

With the Federal Reserve tied up keeping money tight to fight inflation, wouldn’t it [the budget deficit] ‘crowd out’ investment? How could it be financed?

[Robert] Mundell, . . . brushed away the issue, ‘The Saudis will finance that.’ . . . [T]hey did. (The Seven Fat Years, 59)

Bartley was, of course, referring to the great increase in dollar balances controlled not just by Saudi Arabia but by a number of oil-rich nations who had received giant windfalls throughout the 1970s as a result of the rise in the relative price of oil. This point is actually a bit flip, because in the mid-1980s, Saudi Arabia and other oil-rich nations were facing declining revenues due to a near free-fall in oil prices. Most of the net foreign investment during the middle 1980s came from Japan.

33. Table N-11 shows the rising importance of foreign savings between 1983 and 1990.

34. See table N-12. Total private-sector borrowing averaged 88.6 percent of GDP between 1962 and 1969, 96.5 percent of GDP between 1971 and 1973, and 99.5
percent of GDP between 1976 and 1979. Beginning in 1983, total private-sector borrowing averaged 118.9 percent of GDP through 1989. The average was even higher after 1984 (123.7 percent).

35. As did Benjamin Friedman, for example. (see p. 133). Yet Friedman, himself, acknowledged that business was able to borrow record amounts, which is evidence against the role of budget deficits in making borrowing more difficult. See Friedman, Day of Reckoning, 264–65.


Chapter 9

1. Mondale asserted, “Let’s tell the truth. Mr. Reagan will raise taxes, and so will I. He won’t tell you. I just did” (Washington Post, July 20, 1984, 18).

2. ERP 1985, 65. Note the use of GNP rather than GDP. The trend of the debt/GDP ratio is exactly the same as that described by the council. The absolute value of the ratio might vary slightly.

3. Perot, United We Stand, 8. In terms of the burden on taxpayers to service the debt with interest payments, the only really meaningful measure of the national debt is the amount held by the public. A fairly substantial proportion of the total national debt is held within the United States government by various trust funds, including the Social Security trust funds and by Federal Reserve banks.

Table N-13 measures the national debt held by the public and the total

### TABLE N-11. Foreign Savings of Increasing Importance, 1983–90

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Foreign Investment</th>
<th>Gross Private Domestic Investment</th>
<th>Net Private Domestic Investment</th>
<th>Ratio of Net Foreign Investment to Net Domestic Investment (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1983</td>
<td>37.3</td>
<td>547.1</td>
<td>149.3</td>
<td>24.0</td>
</tr>
<tr>
<td>1984</td>
<td>91.5</td>
<td>715.6</td>
<td>304.7</td>
<td>30.0</td>
</tr>
<tr>
<td>1985</td>
<td>116.9</td>
<td>715.1</td>
<td>282.7</td>
<td>41.4</td>
</tr>
<tr>
<td>1986</td>
<td>142.9</td>
<td>722.5</td>
<td>263.1</td>
<td>54.3</td>
</tr>
<tr>
<td>1987</td>
<td>156.4</td>
<td>747.2</td>
<td>264.0</td>
<td>59.2</td>
</tr>
<tr>
<td>1988</td>
<td>118.1</td>
<td>773.9</td>
<td>258.0</td>
<td>45.8</td>
</tr>
<tr>
<td>1989</td>
<td>92.4</td>
<td>829.2</td>
<td>277.3</td>
<td>33.3</td>
</tr>
<tr>
<td>1990</td>
<td>78.6</td>
<td>799.7</td>
<td>223.9</td>
<td>35.1</td>
</tr>
</tbody>
</table>

*Source: Columns 1 and 2: ERP 1996, 302, 280; column 3: Department of Commerce, Bureau of Economic Analysis.*
national debt both in absolute figures and as a percentage of gross domestic product. The data is for fiscal years, and thus the GDP measures will not correspond to calendar years. In 1977, the fiscal year changed from beginning on July 1 to beginning on October 1. Thus for fiscal 1976, the GDP departed much more from calendar year GDP ($1,819 billion, as opposed to the number in table N-13) than in 1977 ($2,026.9 billion, as opposed to the number in table N-13).

4. Table N-14 shows the increased interest payments of the federal government over the last three decades.

5. When I was told this over the phone, I was actually surprised. I had always assumed the Treasury had paid off the Civil War debt in its entirety sometime in the late nineteenth century. Not true, according to the Bureau of the Public Debt. In a 1979 Report of the Secretary of the Treasury (table 19), available on the Web at <www.publicdebt.treas.gov>, the total gross public debt, which stood

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at $75.5 million at the end of 1790, fell to a negligible $37,513 (less than one penny per person) in 1835. It was above $10 million from 1841 to the Civil War and above $1 billion from 1863 to World War I (with 1892 and 1893 as exceptions—it dipped just below $1 billion in those years). At the end of World War I it stood at $24 billion. At the eve of World War II it was $40 billion. At the end of World War II it was $269 billion, which exceeded the GDP.

6. When then-governor Clinton ran for president, he tried to argue that government spending for investment purposes (education, infrastructure) would be

---


<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>National Debt</th>
<th>National Debt (% of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Total</td>
<td>Held by Public</td>
</tr>
<tr>
<td>1960</td>
<td>518.3</td>
<td>290.5</td>
<td>236.8</td>
</tr>
<tr>
<td>1961</td>
<td>530.4</td>
<td>292.6</td>
<td>238.4</td>
</tr>
<tr>
<td>1962</td>
<td>567.3</td>
<td>302.9</td>
<td>248.0</td>
</tr>
<tr>
<td>1963</td>
<td>599.0</td>
<td>310.3</td>
<td>254.0</td>
</tr>
<tr>
<td>1964</td>
<td>639.8</td>
<td>316.1</td>
<td>256.8</td>
</tr>
<tr>
<td>1965</td>
<td>686.8</td>
<td>322.3</td>
<td>260.8</td>
</tr>
<tr>
<td>1966</td>
<td>752.7</td>
<td>328.5</td>
<td>263.7</td>
</tr>
<tr>
<td>1967</td>
<td>811.9</td>
<td>340.4</td>
<td>266.6</td>
</tr>
<tr>
<td>1968</td>
<td>868.0</td>
<td>368.7</td>
<td>289.5</td>
</tr>
<tr>
<td>1969</td>
<td>948.1</td>
<td>365.8</td>
<td>278.1</td>
</tr>
<tr>
<td>1970</td>
<td>1,009.4</td>
<td>380.9</td>
<td>283.2</td>
</tr>
<tr>
<td>1971</td>
<td>1,077.4</td>
<td>408.2</td>
<td>303.0</td>
</tr>
<tr>
<td>1972</td>
<td>1,177.0</td>
<td>435.9</td>
<td>322.4</td>
</tr>
<tr>
<td>1973</td>
<td>1,306.8</td>
<td>466.3</td>
<td>340.9</td>
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<tr>
<td>1974</td>
<td>1,438.1</td>
<td>483.9</td>
<td>343.7</td>
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<td>1975</td>
<td>1,554.5</td>
<td>541.9</td>
<td>394.7</td>
</tr>
<tr>
<td>1976</td>
<td>1,730.4</td>
<td>629.0</td>
<td>477.4</td>
</tr>
<tr>
<td>1977</td>
<td>1,971.4</td>
<td>706.4</td>
<td>549.1</td>
</tr>
<tr>
<td>1978</td>
<td>2,212.6</td>
<td>776.6</td>
<td>607.1</td>
</tr>
<tr>
<td>1979</td>
<td>2,495.9</td>
<td>829.5</td>
<td>640.3</td>
</tr>
<tr>
<td>1980</td>
<td>2,718.9</td>
<td>909.1</td>
<td>709.8</td>
</tr>
<tr>
<td>1981</td>
<td>3,049.1</td>
<td>994.8</td>
<td>785.3</td>
</tr>
<tr>
<td>1982</td>
<td>3,211.3</td>
<td>1,137.3</td>
<td>919.8</td>
</tr>
<tr>
<td>1983</td>
<td>3,421.9</td>
<td>1,371.7</td>
<td>1,131.6</td>
</tr>
<tr>
<td>1984</td>
<td>3,812.0</td>
<td>1,564.7</td>
<td>1,300.5</td>
</tr>
<tr>
<td>1985</td>
<td>4,102.1</td>
<td>1,817.5</td>
<td>1,499.9</td>
</tr>
<tr>
<td>1986</td>
<td>4,374.3</td>
<td>2,120.6</td>
<td>1,736.7</td>
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<tr>
<td>1987</td>
<td>4,605.1</td>
<td>2,346.1</td>
<td>1,888.7</td>
</tr>
<tr>
<td>1988</td>
<td>4,953.5</td>
<td>2,601.3</td>
<td>2,050.8</td>
</tr>
<tr>
<td>1989</td>
<td>5,351.8</td>
<td>2,868.0</td>
<td>2,189.9</td>
</tr>
<tr>
<td>1990</td>
<td>5,684.5</td>
<td>3,206.6</td>
<td>2,410.7</td>
</tr>
<tr>
<td>1991</td>
<td>5,858.8</td>
<td>3,598.5</td>
<td>2,688.1</td>
</tr>
<tr>
<td>1992</td>
<td>6,143.2</td>
<td>4,002.1</td>
<td>2,998.8</td>
</tr>
<tr>
<td>1993</td>
<td>6,470.8</td>
<td>4,351.4</td>
<td>3,247.5</td>
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<tr>
<td>1994</td>
<td>6,830.4</td>
<td>4,643.7</td>
<td>3,432.1</td>
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<tr>
<td>1995</td>
<td>7,186.9</td>
<td>4,921.0</td>
<td>3,603.4</td>
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<tr>
<td>1996</td>
<td>7,484.7</td>
<td>5,181.9</td>
<td>3,733.0</td>
</tr>
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</table>

extremely important. President Bush ridiculed that idea, claiming that “they call it investment, but it’s the same old government spending.” In short, it’s the same old wasteful government spending.

7. In fiscal 1948, before rearmament, defense purchases as a percentage of GDP fell to 3.6 percent. They rose to 4.9 percent in fiscal 1949 and 14.2 percent at the height of the Korean War (in fiscal 1953). Despite the end of the war, military purchases remained over 10 percent of GDP for the rest of the 1950s (ERP 1997, 389, 391).

### TABLE N-14. The Impact of Interest Payments on the Federal Budget and of Interest Payments to Foreign Creditors

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>To Rest of World</th>
<th>Percentage of Federal Spending</th>
<th>Total</th>
<th>To Rest of World</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>6.8</td>
<td>.3</td>
<td>7.3</td>
<td>1.3</td>
<td>0.06</td>
</tr>
<tr>
<td>1961</td>
<td>6.3</td>
<td>.3</td>
<td>6.2</td>
<td>1.2</td>
<td>0.06</td>
</tr>
<tr>
<td>1962</td>
<td>6.8</td>
<td>.3</td>
<td>6.2</td>
<td>1.2</td>
<td>0.05</td>
</tr>
<tr>
<td>1963</td>
<td>7.3</td>
<td>.4</td>
<td>6.4</td>
<td>1.2</td>
<td>0.07</td>
</tr>
<tr>
<td>1964</td>
<td>8.0</td>
<td>.5</td>
<td>6.7</td>
<td>1.2</td>
<td>0.08</td>
</tr>
<tr>
<td>1965</td>
<td>8.4</td>
<td>.5</td>
<td>6.7</td>
<td>1.2</td>
<td>0.07</td>
</tr>
<tr>
<td>1966</td>
<td>9.2</td>
<td>.5</td>
<td>6.4</td>
<td>1.2</td>
<td>0.06</td>
</tr>
<tr>
<td>1967</td>
<td>9.8</td>
<td>.6</td>
<td>5.9</td>
<td>1.2</td>
<td>0.07</td>
</tr>
<tr>
<td>1968</td>
<td>11.3</td>
<td>.7</td>
<td>6.2</td>
<td>1.3</td>
<td>0.08</td>
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<tr>
<td>1969</td>
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<td>.8</td>
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<td>1970</td>
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<td>6.8</td>
<td>1.4</td>
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<td>1.8</td>
<td>6.2</td>
<td>1.3</td>
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<td>5.8</td>
<td>1.2</td>
<td>0.22</td>
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<tr>
<td>1973</td>
<td>18.0</td>
<td>3.8</td>
<td>6.7</td>
<td>1.3</td>
<td>0.28</td>
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<td>20.7</td>
<td>4.3</td>
<td>6.8</td>
<td>1.4</td>
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<td>1975</td>
<td>23.0</td>
<td>4.5</td>
<td>6.3</td>
<td>1.5</td>
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<td>4.5</td>
<td>6.8</td>
<td>1.5</td>
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<td>1.5</td>
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<td>10.3</td>
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<td>19.0</td>
<td>11.0</td>
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</tr>
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<td>113.1</td>
<td>21.2</td>
<td>12.7</td>
<td>3.0</td>
<td>0.56</td>
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<tr>
<td>1985</td>
<td>127.0</td>
<td>23.0</td>
<td>13.1</td>
<td>3.1</td>
<td>0.57</td>
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<td>1986</td>
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<td>24.1</td>
<td>12.7</td>
<td>3.1</td>
<td>0.56</td>
</tr>
<tr>
<td>1987</td>
<td>136.6</td>
<td>25.3</td>
<td>12.8</td>
<td>3.0</td>
<td>0.56</td>
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<td>146.0</td>
<td>30.2</td>
<td>13.2</td>
<td>3.0</td>
<td>0.62</td>
</tr>
<tr>
<td>1989</td>
<td>164.8</td>
<td>35.9</td>
<td>14.0</td>
<td>3.1</td>
<td>0.68</td>
</tr>
</tbody>
</table>

Source: Calculated from information provided by the U.S. Department of Commerce, Bureau of Economic Analysis.

Note: Except for percentages, figures are in billions of dollars.
8. These numbers are for fiscal years and refer to total federal debt. Federal debt held by the public as opposed to other government agencies fell from 29.3 percent in 1969 to 25.7 percent in 1979 (ERP 1997, 390).

9. Recall from chapter 6 that the Bureau of Economic Analysis calculated the structural deficit as the deficit that would exist if unemployment were 6 percent and expressed that deficit as a percentage of that potential level of gross national product. The switch to GDP as a measurement of total output occurred after these structural-deficit numbers were calculated. As mentioned above, the difference between GDP and gross national product is quantitatively quite small. The Congressional Budget Office has calculated a different measure of potential GDP for those years based on the view that 6.2 percent is the appropriate measure of the NAIRU. By their measure, the increase in the structural deficit is not as dramatic, from 1.2 percent in fiscal 1974 to 2.4 percent in fiscal 1975 (but recall that the tax cut was passed in early 1975, fully halfway through that fiscal year—the full effect of the tax cut was felt in fiscal 1976 when the structural deficit was 3.1 percent of GDP). See Congressional Budget Office, Economic Outlook, 1998–2007, 105.

10. The Congressional Budget Office measure rose from 1.8 percent of potential GDP (NAIRU of 6.2 percent) in fiscal 1981 to 2.0 percent in fiscal 1982 to 3.7 percent in fiscal 1983. (In the latter year, the NAIRU was estimated to have fallen to 6.1 percent). See Congressional Budget Office, Economic Outlook, 1998–2007, 105.

11. See table W-1 at the web site <mars.wnec.edu/~econ/surrender>. The federal deficit as a percentage of GDP went from 2.6 percent in fiscal 1981 to 4.0 percent in fiscal 1982 to 6.1 percent in fiscal 1983 (ERP 1997, 390).

12. See table W-1 at the web site. Note that the structural federal deficit was larger than the total government deficit in the mid-to-late 1980s and the early 1990s because unemployment was actually below the 6 percent benchmark, and state and local governments were once again counteracting some of the federal deficit with surpluses. Because the 1990 tax increases were phased in over time and because fiscal 1990 actually ended before the tax increase went into effect, the Congressional Budget Office’s measure of the structural deficit actually rose from 2.8 percent of GDP in fiscal 1989 to 3.1 percent in fiscal 1990 to 3.3 percent in fiscal 1991. This is a far cry, however, from the changes between 1974 and 1976 and from 1981 to 1983. See notes 9 and 11 to this chapter.


14. In 1950, the United States National Security Council drafted a document, NSC 68, that argued that a large-scale military buildup was necessary to fight international communism and that such a buildup could also prop up domestic aggregate demand. Washington resident Gore Vidal remembers hearing Secretary of State John Foster Dulles “predict that this policy would lead to an arms race that the Soviets were certain to lose because they were so much poorer. As a result, the Soviet economy would suffer irreparable harm” (qtd. in Perelman, Pathology of American Economy, 62).


16. Between 1973 and 1984, employee compensation fell from 49.8 percent of total defense spending to 35.2 percent (Rebecca Blank and Emma Rothschild,
“The Effect of United States Defense Spending on Employment and Output,”

17. Congressional Budget Office, *Defense Spending and Economy*, 42–44. While $10 billion in additional defense spending and government nondefense spending (exclusive of transfer payments) were both calculated to create approximately 250,000 new jobs, if all of the $10 billion were devoted to defense purchases, the job creation would have been 20 percent less.

18. Judith Reppy estimated in 1985 that 42 percent of the scientific personnel in the United States were employed in defense-related work (“Military R & D and the Civilian Economy,” *Bulletin of the Atomic Scientists* 41 [October 1985]: 11). This is probably an important place to acknowledge that there is a counterargument to the position articulated in this section. That argument is given by James Cypher in “Military Spending, Technical Change, and Economic Growth: A Disguised Form of Industrial Policy?” *Journal of Economic Issues* 21 (March 1987): 33–59. Cypher argues that the military has always been an important prop to technological progress. He supports this argument with aggregate data (pp. 40–43) as well as references to case studies (pp. 43–47). He approvingly quotes Robert Reich:

> Large-scale defense and aerospace contracts provided emerging industries in the United States with a ready market that let them quickly expand production and thus gain scale economies and valuable experience. The Pentagon’s willingness to pay a high premium for quality and reliability, moreover, helped emerging industries bear the cost of refining and “debugging” their products. (Reich, *The Next American Frontier* [New York: Times Books, 1983], 102, qtd. in Cypher, 44)

Cypher continues by citing “the military’s role in promoting the U.S. semiconductor and aircraft industries—both of which exhibited world leadership through the mid-1970s” (44). He approvingly quotes Merritt Roe Smith:

> The military has been an important agent of technological and managerial innovation. By linking national defense with national welfare, it has sponsored all types of research and development and has served as an important disseminator of new technologies. Just as it helped to inaugurate the industrial revolution in America, it continues to alter the structure of industrial society today. (Smith, *Military Enterprise and Technological Change* [Cambridge: MIT Press, 1985], 36, qtd. in Cypher, 45)

Cypher asserts that military programs played significant roles in numerous technological advances, including standardization, metalworking, steel modernization, the spread of Taylorism, and the Ford-style mass production technology (p. 45).

The point Cypher and others make in response to the analysis in the text is that the huge military spending of the United States government has been the conduit through which the funds necessary to drive the incentives of the private sector toward technological advancement have come. To assert as Melman and others have that military spending has sapped productivity growth is to miss that fact that absent military spending, American private enterprise would have had less incentive to produce the technological progress that has occurred. Note, by the way, that this point of view fits with the argument raised very early in this book (see chap. 1, n. 17) that the role of government has been to subsidize particular enter-
prises and to make sure the low-risk profits flow to those already powerfully situated. As we mentioned then, this is an intriguing position, made stronger by the historical studies that have backed it up. (Reich’s and Smith’s examples in the works cited by Cypher are two cases in point.) Nevertheless, this writer believes on balance that in the most recent period, the expansion of military spending has probably done more harm than good to American productivity growth. In any event, a dispute over what has caused productivity growth to be so slow in the 1980s does not change the fact that despite the changes instituted by the supply-siders, productivity growth did not revive.


21. The federal nonmilitary structures include industrial, educational, and hospital buildings plus an overall category (“other”) that includes office buildings, courthouses, auditoriums, garages, and airline terminals. Other structures are highways and streets, conservation and development structures (like dams), and electric and gas facilities, transit systems, and (civilian) airfields. The state and local structures are divided among educational and hospital and “other” buildings. The “other” category includes the same types as under the federal rubric plus police and fire stations. Nonbuilding structures include those already mentioned under the federal government plus sewer systems and water supply facilities. See Bureau of Economic Analysis, Department of Commerce, Fixed Reproducible Tangible Wealth in the United States, 1925–89 (Washington, DC: Government Printing Office, 1993), 421, 423.

22. We begin in 1961 since that is the starting point for KJN in the previous chapter. However, we end the period with the data from the Department of Commerce through 1989 because that is the final year in which Reagan administration decisions had an impact. I have summarized this information in table W-6 at the web site, <mars.wnec.edu/~econ/surrender>.

23. These calculations are based on 1961–69 for KJN, 1970–80 for NFC, and 1981–89 for VRB. Changing NFC to 1970–81 changes the ratio of infrastructure spending to GDP to 2.47 percent. VRB changes to 1.99 when we shorten the period to 1982–89. Since this analysis deals only with the spending priorities of different administrations, it seems appropriate to begin VRB with the first budget in which Reagan priorities had an impact. As is clear from chapter 5, there was an effort in the early months of the administration to reverse some of the budget decisions already made for fiscal 1981. There was no such activity on the part of the Nixon administration, and thus it is appropriate to begin NFC with the year 1970. For details see tables W-7 and W-8 at the web site <mars.wnec.edu/~econ/surrender>. A less precise estimate has been available from the Bureau of Economic Analysis since 1996. They give figures for expenditures on nondefense equipment and structures by the federal government and on equipment and structures by state and local governments (ERP 1997, 321). The ratios are 3.38 percent for KJN, 2.47 percent for NFC, and 2.04 percent for the Reagan years. The data is collected in table W-9 at the web site.

24. The percentages of GDP devoted to this area of infrastructure investment fell from 0.70 in KJN to 0.53 in NFC to 0.25 in VRB.


27. Ibid., 5.

28. Ibid., 8–9. For more details, see pp. 18–23.

29. Ibid., 24. This is spelled out in detail on pp. 24–25.

30. Ibid., 28.

31. The four major recommendations with numerous implementing recommendations are in ibid., 24–31.

32. Ibid., 33.

33. Table N-15 shows the data from 1960 through 1988.

34. The Congressional Budget Office estimated total national health expenditures at $247 billion in 1980 and $697 billion in 1990. This represented an increase from 8.9 percent to 12.1 percent of GDP (Economic Outlook, 1998–2007, 126).

35. The information in table N-16 has been collected by the Employee Benefit Research Institute (web address <www.ebri.org>). Unfortunately, there are significantly different numbers for employer spending on health insurance premiums and employer spending on private health insurance. I have included both data sets in the table. It is conceivable that the difference between the ratios has to do with the fact that column 3 was updated more recently. The important point is that both ratios rise significantly over the decade.


37. Health expenditures as a percentage of GDP rose from 9.2 percent in 1980 to 13.2 percent in 1991. By 1989, 14 percent of the population was not covered by any health insurance (Mishel and Bernstein, State of Working America, 1994–95, 298, 305).


40. See pp. 75–78.

41. “[I]n 1980 . . . thrifts earned an average yield of 9¼ percent on outstanding mortgages, while the prevailing rate on newly issued mortgages was about 12½ percent. Since the market value, or price, of a fixed-rate asset falls as the interest rate rises, the sharp increase in mortgage interest rates slashed the value of the outstanding mortgages held by S & Ls” (Economic Report of the President, 1991, 168).

42. “By 1980, the net worth of the entire industry measured at market value was actually negative” (John B. Shoven, Scott B. Smart, and Joel Waldfogel, “Real Interest Rates and the Savings and Loan Crisis: The Moral Hazard Premium,” Journal of Economic Perspectives 6 [1992]: 159).


44. ERP 1991, 172.

45. Shoven, Smart, and Waldfogel, “Real Interest Rates,” 165.

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>Total Government Expenditures on Elementary and Secondary Education</th>
<th>Federal Grants to State and Local Governments for Elementary and Secondary Education</th>
<th>Elementary and Secondary Education Expenditures (% of GDP)</th>
<th>Federal Grants (% of total expenditures on elementary and secondary education)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>526.6</td>
<td>14.919</td>
<td>.252</td>
<td>2.83</td>
<td>0.05</td>
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<tr>
<td>1961</td>
<td>544.8</td>
<td>16.335</td>
<td>.262</td>
<td>3.00</td>
<td>0.05</td>
</tr>
<tr>
<td>1962</td>
<td>585.2</td>
<td>17.379</td>
<td>.278</td>
<td>2.97</td>
<td>0.05</td>
</tr>
<tr>
<td>1963</td>
<td>617.4</td>
<td>18.944</td>
<td>.287</td>
<td>3.07</td>
<td>0.05</td>
</tr>
<tr>
<td>1964</td>
<td>663.0</td>
<td>20.971</td>
<td>.343</td>
<td>3.16</td>
<td>0.05</td>
</tr>
<tr>
<td>1965</td>
<td>719.1</td>
<td>23.043</td>
<td>.394</td>
<td>3.20</td>
<td>0.05</td>
</tr>
<tr>
<td>1966</td>
<td>787.8</td>
<td>26.362</td>
<td>1.787</td>
<td>3.35</td>
<td>0.23</td>
</tr>
<tr>
<td>1967</td>
<td>833.6</td>
<td>29.186</td>
<td>1.762</td>
<td>3.50</td>
<td>0.21</td>
</tr>
<tr>
<td>1968</td>
<td>910.6</td>
<td>31.958</td>
<td>1.895</td>
<td>3.51</td>
<td>0.21</td>
</tr>
<tr>
<td>1969</td>
<td>982.2</td>
<td>35.248</td>
<td>1.830</td>
<td>3.59</td>
<td>0.19</td>
</tr>
<tr>
<td>1970</td>
<td>1,035.6</td>
<td>39.286</td>
<td>2.143</td>
<td>3.79</td>
<td>0.21</td>
</tr>
<tr>
<td>1971</td>
<td>1,125.4</td>
<td>43.538</td>
<td>2.265</td>
<td>3.87</td>
<td>0.20</td>
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<tr>
<td>1972</td>
<td>1,237.3</td>
<td>47.470</td>
<td>2.840</td>
<td>3.84</td>
<td>0.23</td>
</tr>
<tr>
<td>1973</td>
<td>1,382.6</td>
<td>52.029</td>
<td>2.519</td>
<td>3.76</td>
<td>0.18</td>
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<tr>
<td>1974</td>
<td>1,496.9</td>
<td>57.947</td>
<td>3.189</td>
<td>3.87</td>
<td>0.21</td>
</tr>
<tr>
<td>1975</td>
<td>1,630.6</td>
<td>66.322</td>
<td>3.660</td>
<td>4.07</td>
<td>0.22</td>
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<tr>
<td>1976</td>
<td>1,819.0</td>
<td>71.800</td>
<td>2.742</td>
<td>3.95</td>
<td>0.15</td>
</tr>
<tr>
<td>1977</td>
<td>2,026.9</td>
<td>76.993</td>
<td>3.532</td>
<td>3.80</td>
<td>0.17</td>
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<tr>
<td>1978</td>
<td>2,291.4</td>
<td>83.242</td>
<td>4.000</td>
<td>3.63</td>
<td>0.17</td>
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<tr>
<td>1979</td>
<td>2,557.5</td>
<td>92.526</td>
<td>4.775</td>
<td>3.62</td>
<td>0.19</td>
</tr>
<tr>
<td>1980</td>
<td>2,784.2</td>
<td>101.129</td>
<td>5.235</td>
<td>3.63</td>
<td>0.19</td>
</tr>
<tr>
<td>1981</td>
<td>3,115.9</td>
<td>108.342</td>
<td>5.209</td>
<td>3.48</td>
<td>0.17</td>
</tr>
<tr>
<td>1982</td>
<td>3,242.1</td>
<td>116.259</td>
<td>5.108</td>
<td>3.59</td>
<td>0.16</td>
</tr>
<tr>
<td>1983</td>
<td>3,514.5</td>
<td>124.267</td>
<td>4.258</td>
<td>3.54</td>
<td>0.12</td>
</tr>
<tr>
<td>1984</td>
<td>3,902.4</td>
<td>134.888</td>
<td>5.888</td>
<td>3.46</td>
<td>0.15</td>
</tr>
<tr>
<td>1985</td>
<td>4,180.7</td>
<td>145.128</td>
<td>5.953</td>
<td>3.47</td>
<td>0.14</td>
</tr>
<tr>
<td>1986</td>
<td>4,422.2</td>
<td>157.042</td>
<td>5.953</td>
<td>3.55</td>
<td>0.13</td>
</tr>
<tr>
<td>1987</td>
<td>4,692.3</td>
<td>168.831</td>
<td>5.464</td>
<td>3.60</td>
<td>0.12</td>
</tr>
<tr>
<td>1988</td>
<td>5,049.6</td>
<td>181.484</td>
<td>6.731</td>
<td>3.59</td>
<td>0.13</td>
</tr>
</tbody>
</table>


*In billions of dollars.

46. Ibid., 161, 165–66.

47. “By the end of 1990, the Department of Justice had obtained nearly 400 convictions in major fraud cases in connection with the S & L crisis” (ERP 1991, 173).

48. The 1992 report of the Council of Economic Advisers noted, “The expansion of deposit insurance that did not account for the riskiness of an institution’s
investments enabled weak banks and S & Ls to stay open and to overinvest in risky assets without losing depositor confidence” (ERP 1992, 25).

49. In support of the first set of numbers as the more accurate, the Council of Economic Advisers argues, “The [larger] estimates are obtained by adding up all the future repayments. . . . Such an estimate would be akin to claiming that a 10-percent 30-year, $100,000 home mortgage costs $315,925, which in fact is the undiscounted sum of the repayments required by that mortgage” (ERP 1991, 173). The word “undiscounted” is key, here. Income you receive in the future is worth less than the same amount of money received today—that’s why lenders demand, and borrowers are willing to pay, interest. Repayments in the future cost less in today’s dollars than they will when they have to be paid because, in anticipation of having to make that payment, one could invest a smaller sum and watch it grow to the amount needing to be paid out.

52. The wide range of estimates is based both on the wide range of possible impacts on the rate of interest (anywhere from 0.5 percent to 2.5 percent) paid by the government on its outstanding debt as well as the time rate of discount used to collapse the cost into present value terms. See Shoven, Smart and Waldfogel, “Real Interest Rates,” 266.
53. ERP 1991, 177.
54. This argument has been facetiously taken to its logical conclusion with the suggestion that the way to guarantee safe driving is to mandate that every steer-
ing wheel come equipped with a permanent harpoon aimed at the chest of the driver to guarantee that the driver will not collide with anything!

55. 1993 Green Book, 1525.
59. 1993 Green Book, 1531. Interest, dividend, and rental income for the top 1 percent went from 24.6 percent of their total income to 21.8 percent in 1985, not so much because their received less interest, dividend, and rental income but because their ability to receive income in capital gains increased so dramatically.
61. Ibid.
62. Wolff calculates that between 1922 and 1989 (with twenty separate observations), three-fifths of wealth inequality can be attributed to income inequality and two-fifths to relative increases in stock prices to home prices (ibid., 12–13).
63. With such ownership concentrated heavily in the top 5 percent of the population. For the years 1980, 1985, and 1990 the income from capital for the top 5 percent and 1 percent of the population is detailed in table N-17.
65. Ibid., 146.
68. Ibid., 25.
70. Lindsey, The Growth Experiment, 82.
71. In 1990, both ratios began to fall, dominated by the decline in nominal interest rates that actually reduced total personal interest income in absolute terms between that year and 1993 (ERP 1997, 330).
72. See Bartley, The Seven Fat Years, 272–73.
73. Ibid., 278.
76. Ibid., 4.
77. This battle still raged three years later. See, for example, “Dick Armey’s Research” letters from U.S. Representative Dick Armey (R.-TX) and a response by Michael Lind, New York Times Book Review, August 20, 1995, 27.
78. “The lower and upper boundaries are $18,500 and $55,000, respectively, in
1987 dollars and are applied to all years using the CPI-UXI price index” (Timothy Smeeding, Greg Duncan, and Willard Rodgers, “W[h]ither the Middle Class?” Policy Studies Paper No. 1, Metropolitan Studies Program, Income Security Policy Series, Maxwell School of Citizenship and Public Affairs, Syracuse University, February 1992, 5). The specifics of the index used need not concern us here. The important point is that once they have established an absolute standard of what constitutes the “middle class” the authors adjust that standard to take account of inflation for all the other years in the survey. This permits them to see if people who were in the absolutely defined middle class in 1967 stayed there over the next

---

**TABLE N-17. Interest, Dividends, and Capital Gains for High-Income Families**

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage of Rents, Interest, and Dividends Realized by Top 5 Percent of Families</th>
<th>Percentage of Capital Gains Realized by Top 5 Percent of Families</th>
<th>Percentage of Rents, Interest, and Dividends Received by Top 1 Percent of Families</th>
<th>Percentage of Capital Gains Received by Top 1 Percent of Families</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>46.8</td>
<td>75.5</td>
<td>26.0</td>
<td>57.6</td>
</tr>
<tr>
<td>1985</td>
<td>45.4</td>
<td>84.9</td>
<td>26.4</td>
<td>68.1</td>
</tr>
<tr>
<td>1990</td>
<td>49.8</td>
<td>84.7</td>
<td>30.5</td>
<td>68.5</td>
</tr>
</tbody>
</table>

*Source: 1993 Green Book, 1528-29.*

**TABLE N-18. Social Mobility between Quintiles, 1977–86**

<table>
<thead>
<tr>
<th>Family Income Quintile in 1977</th>
<th>Bottom</th>
<th>Second</th>
<th>Third</th>
<th>Fourth</th>
<th>Top</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bottom</td>
<td>10.6</td>
<td>5.0</td>
<td>2.2</td>
<td>1.3</td>
<td>0.8</td>
<td>20.0</td>
</tr>
<tr>
<td>Second</td>
<td>4.3</td>
<td>6.0</td>
<td>5.1</td>
<td>2.9</td>
<td>1.7</td>
<td>20.0</td>
</tr>
<tr>
<td>Third</td>
<td>2.9</td>
<td>3.8</td>
<td>5.9</td>
<td>4.8</td>
<td>2.6</td>
<td>20.0</td>
</tr>
<tr>
<td>Fourth</td>
<td>1.0</td>
<td>2.9</td>
<td>4.3</td>
<td>6.8</td>
<td>5.0</td>
<td>20.0</td>
</tr>
<tr>
<td>Top</td>
<td>1.2</td>
<td>2.2</td>
<td>2.5</td>
<td>4.1</td>
<td>10.0</td>
<td>20.0</td>
</tr>
<tr>
<td>Total</td>
<td>20.0</td>
<td>20.0</td>
<td>20.0</td>
<td>20.0</td>
<td>20.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>


**TABLE N-19. Real Family Incomes of Individuals Averaged over Ten Years**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bottom</td>
<td>$18,293</td>
<td>$18,579</td>
<td>2</td>
</tr>
<tr>
<td>Second</td>
<td>32,785</td>
<td>34,084</td>
<td>4</td>
</tr>
<tr>
<td>Third</td>
<td>42,636</td>
<td>46,082</td>
<td>8</td>
</tr>
<tr>
<td>Fourth</td>
<td>54,100</td>
<td>60,594</td>
<td>12</td>
</tr>
<tr>
<td>Top</td>
<td>83,486</td>
<td>101,286</td>
<td>21</td>
</tr>
<tr>
<td>All</td>
<td>46,260</td>
<td>52,125</td>
<td>13</td>
</tr>
</tbody>
</table>

twenty-one years. Note that it is essential to have an absolute standard because if we merely identified the same ratio (between the lowest 20 percent and the top 10 percent) we would have the same number of households (70 percent of them) each year! Smeeding, Duncan, and Rodgers use another measure of the middle class that adjusts for family size. In this case, the middle class consists of families with incomes from two times to six times the family’s “poverty threshold,” which varies according to family size (in 1990 it was thirteen thousand dollars for a family of four). Their results show similar patterns for this measure and the original one. (I am indebted to Professor Smeeding for sending me this paper.)

79. Smeeding, Duncan, and Rodgers, in “W(h)ither the Middle Class?” created table N-20, which they title “Percent of Adults Making Key Income Transitions.” The high-income transitions involve either a middle-income individual moving above the high-group threshold of income, or someone from that group “falling out” into the middle class. The low-income transitions involve either a middle-income person falling below the middle-class threshold or a person from that low-income group “climbing out” into the middle class. One should not be misled by the high percentages of high-income people “falling out” compared to the seemingly low percentage of middle-income people “climbing out” because, remember, the middle-income group represents close to 70 percent of the population, while the high-income group to begin with represents only 10 percent of the population, while the lower-income group is only 20 percent. In absolute numbers 6.7 percent of 70 percent of the population is much higher than 29.1 percent of 10 percent of the population. (If there were one thousand people in the population, 6.7 percent of 70 percent would be about forty-seven people, while 29.1 percent of 10 percent would be twenty-nine people!) Instead, the most important numbers above are the differences between the probabilities of social mobility before 1980 and after 1980.

80. Smeeding, Duncan, and Rodgers, “W(h)ither the Middle Class?” 24.


82. Mishel and Bernstein, State of Working America, 1994–95, 188.

83. Ibid., 189.

84. Ibid.

85. Ibid., 150.

86. ERP 1995, 321.


88. In 1979, American workers averaged 43.6 weeks per year of work and 38.6 hours per week. By 1989, those numbers had grown to 45.2 and 39.0 respectively (Mishel and Bernstein, State of Working America, 1994–1995, 112). Working wives’ contributions to the income of married couples increased from 26 percent in 1979 to 29 percent in 1989 (ibid., 62).

According to Schor,

A 1989 poll found nearly two-thirds expressing the desire to give up an average of 13 percent of their current paycheck for more free time. Eight of ten respondents indicated they would forego a faster career track for a slower one which would allow them more time to spend with their families. A second survey found that 70 percent of those earning $30,000 a year or more would give up a day’s pay each week for an extra day of free time. Surprisingly, even among those earning only $20,000 a year, 48 percent said they would do the same. . . . even a decade ago, only a very small percentage of Americans preferred to give up income for time. (Schor and Leete-Guy, “The Great American Time Squeeze,” 1)


91. See Schor, \textit{The Overworked American}, 72–82.
92. Ibid., 60.
93. Ibid., 194.

Chapter 10

1. Actually, his election was pretty much guaranteed by the good economy in 1988. Except for 1952, 1968, and 1976, since World War II the party in power has lost the presidency only if there is a recession during the election year. The recession of 1960 appears to have cost Richard Nixon the presidency his first time around, and the recession of 1980 clearly was the cause of President Jimmy Carter’s failure to win reelection. In the years 1956, 1964, 1972, and 1984 the incumbent had

\begin{table}[h]
\centering
\caption{Percentage of Adults Making Key Income Transitions}
\begin{tabular}{llll}
\hline
 & All Years & Before 1980 & 1980 and After \\
\hline
 \multicolumn{4}{c}{High income transitions} \\
Percentage of middle-income individuals & 6.7 & 6.3 & 7.5 \\
climbing out & & & \\
Percentage of high-income individuals & 29.7 & 31.1 & 27.1 \\
falling out & & & \\
\hline
 \multicolumn{4}{c}{Low-income transitions} \\
Percentage of low-income individuals & 33.6 & 35.5 & 30.4 \\
climbing out & & & \\
Percentage of middle-income individuals & 7.0 & 6.2 & 8.5 \\
falling out & & & \\
\hline
\end{tabular}
\end{table}

\textit{Source:} Smeeding, Duncan and Rodgers, “W(h)ither the Middle Class,” 13.
no trouble winning—in fact we could characterize all four elections as landslides. In 1952, the candidate was General Eisenhower, a highly popular figure running against a relative unknown in the middle of an unpopular war. In 1968, the Democratic Party was considered the party of the unpopular Vietnam War. In 1976, Gerald Ford was running for reelection in the aftermath of both Watergate and the recession of 1975—and he had pardoned Richard Nixon.

2. His Council of Economic Advisers’ first Economic Report argued,

A key item on the Administration’s economic agenda, reducing the tax rate on capital gains, will enhance all types of investment. Cutting the capital gains tax rate will lower the cost of investment funds and thus stimulate investment. Much of the reward to entrepreneurial activity, such as generating new technology and bringing it to market, comes in the form of an increase in the value of businesses. Reducing the capital gains tax rate will thus reward these efforts and encourage invention and innovation. (ERP 1990, 25)

In his last State of the Union address (January 1992) Bush was still insisting that he “must” have a “capital gains tax cut” as part of his policy to stimulate growth (ERP 1992, 4).

4. See chap. 7, table 10.
5. ERP 1991, 63. For details on the act, see pp. 64–65.
7. The Bush administration’s assertions about a slight fall refer to fiscal years, not calendar years (ERP 1991, 66). The Congressional Budget Office calculation identifies a rise in the structural deficit from 2.8 percent of GDP in fiscal 1989 to 3.1 percent in fiscal 1990 and 3.3 percent in fiscal 1991 (Congressional Budget Office, Economic Outlook, 1998–2007, 105). Clearly, the administration was using a different standard for measuring the structural deficit than the CBO. Between fiscal 1989 and fiscal 1990, the actual federal deficit rose from 2.8 percent of GDP to 3.9 percent of GDP (ERP 1997, 390).
8. Bartley, The Seven Fat Years, 281.
9. Spending over which Congress has year-to-year control (discretionary spending) was grouped into three categories: domestic, defense, and international. Each of these areas of the budget was capped for 1991 through 1993, after which all three areas would be merged for fiscal 1994 and 1995. The law then reintroduced the G-R-H automatic mechanism. If discretionary spending were to exceed the caps, that would trigger a sequester in that part of the budget. If mandatory spending or tax cuts were voted that were not “paid for” elsewhere in the budget, that, too, would trigger a sequester (ibid., 66). When fiscal 1997 ended on September 30, the federal deficit had fallen to a minuscule $22 billion. In a news analysis published in January 1998, Robert Reischauer, who headed the Congressional Budget Office from 1989 to 1995, is quoted as concluding that the spending constraints and tax increases in this bill accounted for the largest single contribution to deficit reduction in the seven years from its passage until the middle of 1997 (see Pear, “Budget Heroes Include Bush and Gorbachev”).
11. Ibid., 14. The report given by this staff member predicted that as a result
of price pressures in the first quarter of the year, the Fed expected the consumer price index to rise more than 5 percent in 1989, justifying increased tightening of monetary policy. See Michael J. Prell, “FOMC Briefing—Domestic Economic Outlook,” appendix, Staff Papers to the Federal Open Market Committee meeting, 2.

12. Transcript, Federal Open Market Committee Meeting, 21.
13. Ibid., 28.
14. Transcript, Federal Open Market Committee Meeting, 42. In fact, the Fed hit the M2 target almost exactly; the increase between March and June was 2.97 percent on an annual basis. M3 grew slower than planned, at 3.23 percent (Money Stock: Federal Reserve Board). The Federal Funds rate stayed within the target range, rising from 9.65 percent in March to 9.84 in April and trending downward to 9.53 in June (ERP 1991, 369).

15. Bureau of Economic Analysis, Department of Commerce (per capita gross domestic product in chained 1992 dollars). The Bush administration identified the recession as beginning in the fourth quarter of 1990, contradicting the NBER, which dated it from the third. The Bush Council of Economic Advisers also tried to blame the recession on the “oil price shock, the sudden drop in consumer and business confidence, and the uncertainty about when the Persian Gulf crisis would end” (ERP 1991, 22) but then immediately acknowledged that the Federal Reserve had initiated a more restrictive monetary policy in the spring of 1988 to ward off an increase in the underlying inflation rate. The lagged effects of this policy also slowed the economy in 1989 and 1990, as higher interest rates discouraged spending (p. 23).

20. ERP 1991, 158.
21. ERP 1992, chap. 5
22. ERP 1993, 175. The report noted that automobiles manufactured before the 1980 model year were only 29 percent of vehicles on the road but caused 53 percent of hydrocarbon and 51 percent of carbon monoxide pollution. Buying up old vehicles still on the road, therefore, was a fruitful way of reducing air pollution.

23. Note that this is the same argument exemplified by the conservative economists’ view that vigorous antitrust prosecutions are unnecessary anachronisms. The opposition, of course, argued that without regulation “free competition” would lead to a few giants winning and controlling unacceptably high percentages of the communications media. The Clinton administration agreed with the congressional majority on a telecommunications reform bill, which was finally passed in 1996 (ERP 1997, 200–202).

24. ERP 1993, 199.
29. ADA Compliance Manual, 2.
30. “The EEOC has estimated that 10,000–12,000 disability discrimination
charges will be filed in the first year after the law goes into effect, an increase of 15–20 percent in its caseload” (Robert L. Duston, “What Every College and University Administrator Needs to Know about the ADA, and Why,” conference manual for the College and University Personnel Association conference on the Americans with Disabilities Act, April 11–12, 1992 [available from Robert L. Duston, Schmeltzer, Aptaker & Shepard, P.C., Washington, DC], table 4-2).


34. The vote was five to four, with the three Reagan appointees (O’Connor, Scalia, and Kennedy) joining Chief Justice Rehnquist and Byron White for the majority. See Wards Cove Packing Co. v Atonio 490 U.S. 642 (1989). For the previous precedent, see Griggs v Duke Power Co. 401 U.S. 424 (1971).

35. It is thought by many that this agreement was won due to the strong efforts of Senator James Danforth (R.-MO), who was Thomas’s principal supporter in the Senate and cosponsor of the Civil Rights Act of 1991.


38. The “Reagan Democrats” are longtime Democratic voters, blue-collar workers, and other middle-class people who voted in increasing numbers for Ronald Reagan in 1980 and 1984 and stayed with George Bush in 1988—this despite the fact that in state and congressional elections they continued to vote for Democrats.

39. ERP 1991, 71. They concluded by predicting that unemployment would decline in that year, a prediction that appeared almost foolproof since such a decline had occurred in all previous postwar recoveries.

40. The real GDP in 1976 ended up 5.6 percent higher than in the previous year. The real GDP in 1983 ended up 4.0 percent higher than in 1982 (ERP 1997, 302).

41. ERP 1997, 302.

42. In real dollars, GDP per capita was $24,033 in the first quarter of 1991, at the trough of the recession. In the first quarter of 1992, it was $24,280. For the first eight quarters after the trough in 1991, growth in real GDP per capita averaged 1.2 percent per quarter. By contrast, the first eight quarters after the trough in 1982 produced an average rate of growth of 5.3 percent. The first eight quarters after the trough in 1975 produced an average of 4.0 percent (Bureau of Economic Analysis, Department of Commerce, “Per Capita Gross Domestic Product—Chained (1992 Dollars,”) unpublished data.

43. The same held for the prime rate and for the real Federal Funds and prime rates (calculated using the expected rate of inflation).

44. ERP 1995, 359.

45. ERP 1997, 332.
47. 1993 Green Book, 491.
52. ERP 1995, 314.
53. There was a brief uptick in fiscal 1992. Table N-21 shows the trend in defense spending as a percentage both of GDP and of federal spending during this period. The Congressional Budget Office has a significant rise in defense spending in fiscal 1991, and some of its figures differ from the figures in the Economic Report. Perhaps the CBO included funds that were contributed by our allies toward the Gulf War, while the Economic Report did not. See Congressional Budget Office, Economic Outlook, 1998–2007, 114.
56. See above, pp. 118–19.
57. Coughlin, Ku, and Holahan, Medicaid since 1980, 104.
58. Perot, United We Stand, 35.
59. In a more detailed description of what was wrong with the U.S. economy between 1980 and 1992, Perot seems to be blaming a decline in savings, the budget deficit, the national debt, and a decline in competitiveness. Carefully perusing the relevant pages in Not for Sale at Any Price provides lots of good information about the failures of the U.S. economy since the early 1970s but no real analysis of why that failure occurred. Losing out to foreign competition is mentioned, and there is a quote attributed to a “friend in Japan”: “In Japan we think ten years ahead, in the United States you think ten minutes ahead” (64). That hardly passes for explanation. See Not for Sale, 32–95.
60. United We Stand, 34–56.
61. Clinton would be expected to criticize the economic policies of the current administration. Mondale had tried the same in 1984, as had Dukakis and Bentsen.
in 1988. The combination of the recession and Perot’s criticisms made Clinton’s appear less partisan (that is, fake) and more accurate. For a Perot assault on “trickle-down economics” see Not for Sale, 69–77.

62. For some details, see Perot, United We Stand, 40–51, and Not for Sale, 101–10.

63. In fact, according to Bob Woodward’s “insider” account The Agenda: Inside the Clinton White House (New York: Simon and Schuster, 1994), the sign had three lines listing the “three-pronged message” of the Clinton campaign: “Change vs. more of the same. The economy, stupid. Don’t forget health care.” The version in the text and the public consciousness is in fact a slightly incorrect version of only one-third of the sign. See The Agenda, 54, and the accompanying note.


65. Ibid., 29. Details of the stimulus package are spelled out on pp. 29–39.

66. There are over twenty pages of proposed increases in public investment and education efforts, both with direct expenditures and tax incentives (ibid., 41–48, 61–63).

67. In addition, the 2.9 percent payroll tax for Medicare was extended to all wage, salary, and self-employment income instead of leaving it capped at $135,000 in 1993. Thus, for people paying the new 36 percent marginal tax rate on income plus the 10 percent surcharge (39.6 percent), if they received wages, salaries, and/or self-employment income in that bracket, the actual marginal tax rate would have risen from 31 percent to 42.5 percent. Note that the 2.9 percent payroll tax for Medicare does not apply to income from interest, rent, dividends, and, most importantly, capital gains.


69. Blinder, The Great Stagflation. Anyway, measured as a percentage of GDP, the total government deficit was only above 1 percent from the first quarter of 1967 through the middle of 1968. For the six quarters from the end of 1968 through the first quarter of 1970, the total government was in surplus. To assert that these two years would produce the run-up in inflation in 1973 and 1974 is dubious indeed.

70. ERP 1996, 371. In calendar year 1978 the total government ran a surplus of $20.9 billion, while in 1979 that surplus totaled $33.8 billion.

71. For the Federal Funds rate, see Board of Governors, Federal Reserve System, table J1-1. For the thirty-year Treasury bill rate, see table J1-10. For the structural deficit, see W-1 at the web site, <mars.wnec.edu/~econ/surrender>.

72. See table W-9 at the web site <mars.wnec.edu/~econ/surrender> for the details.

73. The full projection in A Vision of Change for America involved a net increase of $13 billion in spending in 1993. In 1994 deficit reduction cuts and revenue increases would be $66 billion, but the rest of the stimulus coupled with the beginning of new public investments would reduce that, resulting in a net deficit reduction of $39 billion. Between 1993 and 1998, the plan called for an initial deficit reduction of $704 billion combined with increased public investments, tax reductions (and the stimulus package) totaling $231 billion, for a net deficit reduction of $473 billion. See p. 22 for details. As a percentage of GDP, the deficit was projected to fall from 5.4 percent in 1993 to 2.7 percent in 1997. Absent reform in health care,
the Clinton administration predicted an increase in the deficit for 1998, which would increase the deficit as a percentage of GDP to 3.1. In fact the rapidly growing economy in 1996 and 1997 coupled with the August 1997 agreement led to a virtual disappearance of the deficit by the beginning of fiscal 1998 (see Pear, note 9 in this chapter).

75. A Vision of Change for America, 22; and ERP 1994, 32. The Reischauer analysis quoted by the *New York Times* (see Pear, note 9 in this chapter) gives significant credit for succeeding—in fact, improving on these targets—to the 1993 deficit reduction package but not as much as to the 1990 one.
76. Between January and December 1993, the thirty-year Treasury bond yield fell from 7.34 percent to 6.25 percent. The gap had fallen to 3.29 by December, despite continued declines in the Federal Funds rate (Board of Governors, Federal Reserve System, table J1-10).
77. ERP 1997, 303.
78. Ibid., 300. For productivity growth, it is necessary to ignore the data in the 1997 economic report and utilize the industry analytical ratios for the nonfarm business sector from the Bureau of Labor Statistics because they recalculated productivity data during 1997.
79. ERP 1994, 35.
80. Ibid.
81. The thirty-year Treasury bond yielded 6.25 percent in January and reached 8.08 percent in November. Thereafter it began to fall, though it did not get below 6.25 percent till December 1995 (Board of Governors, Federal Reserve System, table J1-10). In real terms, it was at 3.75 percent in the first quarter of 1994 and rose to almost 5.5 percent by the end of the year before beginning to fall slowly in 1995.
83. ERP 1994, 34.
84. Ibid., 38.
85. Ibid., 38.
86. ERP 1995, 27.
87. ERP 1995, 27. This was exactly the point I made above (see pp. 174–75) about the inability to give the economy a fiscal stimulus to fight the 1990 recession due to the high deficits that had persisted during the 1980s.
88. ERP 1995, 30.
89. For the details, see tables W-10 through W-12 at the web site, <mars.wnec.edu/~econ/surrender>. They present quarterly data from 1991 to the present and will be updated from time to time.

Chapter 11

1. In terms of regulatory burdens, the Center for the Study of American Business estimated that Clinton’s first budget proposal reversed a slight reduction in federal regulatory spending that had occurred with the last Bush budget (fiscal 1993) and continued to increase actual staff in the various regulatory agencies. See Warren, “Mixed Message,” 4.
2. The misery index, we should recall, sums the unemployment rate and the rate of inflation. Taking the rate of inflation in the consumer price index, we see a misery index of 9.9 percent in 1993, 8.7 percent in 1994, and 8.4 percent in 1995 and 1996. The last time the index had been that low was in 1968 (ERP 1997, 370, 346).


4. ERP 1997, 352. In 1995 the fall resumed, leaving average weekly earnings less than one-half dollar above the 1993 figure in purchasing power.

5. The proposed Health Security Act is described in detail in ERP 1994, chap. 4.

6. Historian Theda Skocpol has written a postmortem on the failure of Clinton’s health care reform. In the following passage she stresses the point we have made herein:

   Historically, Americans have been perfectly happy to benefit from federal government spending, and even to pay higher taxes to finance spending that is generous and benefits more privileged groups and citizens, not just the poor. Such benefits are especially appealing if they flow in administratively streamlined and relatively automatic ways. But Americans dislike federal government regulations not accompanied by generous monetary payoffs. (Boomerang: Clinton’s Health Security Effort and the Turn against Government in U.S. Politics [New York: Norton, 1996], 167)

7. Ibid., chap. 5.

8. The opposition to the Canadian system produced significant amounts of propaganda by anecdote to make it appear that Canadians were all flocking to the United States for operations that the Canadian system routinely refused to perform. This despite the fact that Canadians routinely expressed high levels of satisfaction with their health care system, in much higher percentages than did Americans.

9. Skocpol argues that the political constraints under which Clinton operated precluded his offering a single-payer proposal. Particularly she argues that such a proposal “could easily have been caricatured by fiscal conservatives . . . as a ‘budget buster,’ a new ‘entitlement’ that was bound to get out of control. . . . threatened stakeholders and the populist right would . . . have carried on a devastating scare campaign about a ‘government takeover’ of medical care” (Boomerang, 179). While she is no doubt correct that support for a single-payer plan would have gone against Mr. Clinton’s pro-private-sector instincts, the ability of the groups mentioned to caricature and misrepresent any comprehensive reform suggests that supporting an easily described, easily defended system would have been better than the overly complicated proposal that was also labeled “socialized medicine” by the opposition.

10. It was estimated that the original Clinton proposal would have added approximately $10 billion to the cost of welfare (Todd S. Purdum, “Clinton Remembers Promise, Considers History, and Will Sign,” New York Times, August 1, 1996, A22).


14. The 1996 Green Book provides this account:

According to an HHS compilation, by mid-February 1996, all but 10 States . . . had approval to test departures from specified provisions of AFDC . . . AFDC waiver projects can be classified broadly as restricting or liberalizing some elements of the program. Examples of the former include:

- Place time limit on benefit duration (24 States);
- Tighten work requirements (31 States);
- Link benefits to school attendance/performance (26 States);
- Limit benefits for additional children (14 States);
- Reduce benefits based on relocation (2 States);
- Require fingerprinting as a condition of eligibility (1 State).

Major waiver provisions that liberalize some terms of the program include:

- Treat earnings more generously (30 States);
- Expand eligibility for 2-parent (unemployed) families (25 States);
- Increase resource limit (28 States);
- Increase vehicle asset limit (25 States);
- Expand transitional medical and child care benefits (21 States).


17. $9.5 billion was restored in SSI benefits to legal immigrants, $2 billion in increased Medicaid for these individuals, and $2.7 billion in increased grants to states to help people receiving welfare under the two-year limitation find work. See O’Neill, letter to Raines, 54–55.


19. Congressional Budget Office, Economic Outlook, 1997–2006, chap. 3. It was this readjustment that had so impressed the reporter from the Wall Street Journal in early February 1996 (Calmes, “Clinton’s Fiscal ’97 Budget”).

20. Defenders of the Clinton administration will no doubt point out that they had rallied virtually the entire Democratic congressional caucus to support their proposed minimum-wage increase and that their drumfire of support for the proposal and scorn for the Republicans who opposed it ultimately led to enough Republican defections from the leadership to pass a $.90 per hour increase in the summer of 1996 (Jared Bernstein and John Schmitt, “The Sky Hasn’t Fallen: An Evaluation of the Minimum-Wage Increase,” Briefing Paper, Economic Policy Institute, 1997, 1). The first thing to note about this is that when the Democrats had
the majority in Congress, the Clinton administration never made mention of the need to raise the minimum wage. The second is that this increase will still leave the minimum wage 20 percent below its level in 1979 in purchasing power. It is too early to tell if the increase in the minimum wage has helped reverse the increasing inequality among wage earners. That will be the key issue.

23. For a particularly useful visual picture, see Krugman, “The Right, the Rich.”
24. “[L]evels of wage inequality for men have been greater in recent years than at any time since 1940. Women received wage increases throughout the wage distribution, but the gains were concentrated at the top” (ERP 1995, 176).
26. Ibid.
27. ERP 1995, 184–95.
28. For families, the Gini ratio had peaked at .401 in 1989, fell slightly to .390 in 1991, rose to .401 in 1992, and jumped to .429 in 1993 before falling slightly to .421 in 1995. See Bureau of the Census, Incomes Statistics Branch/HHES Division, Current Population Reports, Series P-60, Table F-4, “Gini Ratios for Families, by Race and Hispanic Origin of Householder: 1947–1995.” For Households, the peak of inequality in 1989 was at .431. The Gini ratio then fell to .428 in 1991, rose to .434 in 1992 and jumped to .454 in 1993. It fell slightly to .450 in 1995. See ibid., Table H-4, “Gini Ratios for Households, by Race and Hispanic Origin of Householder: 1967 to 1995.” We should note that in 1993, the method of collecting the census information was expanded, and much of the measured increase in inequality is probably due to the changed method of data collection. The most crucial point of all this information is that the increase in inequality between 1979 and 1989 was not been reversed despite the long recovery and despite the Clinton administration’s alleged efforts. For the most recent information (as this book goes to press), see ERP 1998, 127.
30. Ibid., 4. This is not definitive evidence about the actual nature of the jobs created because though the “job category” paid “on average” above-median wages, there is a wide variation in wages within each job category. It is possible the newly created jobs would pay less than average for that job category.
31. Ibid., 7–8.
33. ERP 1996, 23. It is interesting to note that one of the results of the revision in how the Department of Commerce’s Bureau of Economic Analysis computed the gross domestic product was to substantially reduce the initial rates of productivity growth for the 1990s. For a quick comparison, check out the Economic Report of the President for 1995 and 1996, table B-46, productivity.
34. ERP 1996, 22.
35. According to the Congressional Budget Office analysis of the combined tax cut and balanced-budget plan passed in the summer of 1997, the Taxpayer Relief Act will increase expenditures under the earned-income tax credit and the
(smaller) child care credit by a total of $11.5 billion through fiscal 2002. See O’Neill, letter to Raines.


37. ERP 1998, 304. These are percentages of government purchases. It does not include transfer payments.


41. ERP 1997, 346.

42. ERP 1996, 361. We might note that such a reduction in the Federal Funds rate was accompanied by an actual shrinkage in M1 throughout 1995, once again demonstrating that the rate of growth of M1 was an unreliable guide to monetary policy. M2 growth was accelerated during 1995 (ERP 1996, 355).

43. For the actions of the Fed in 1997, see ERP 1998, 44. For the unemployment rate month to month, see ibid., 330. By the middle of 1997 the reason for the Fed’s behavior became apparent as insider newsletters were reporting a rising fear that the economy might “overshoot” the target of zero inflation and experience deflation. By the end of 1997, with the Asian financial crisis making investors nervous, there was even talk that the Fed might have to lower interest rates despite the fact that unemployment had fallen below 5 percent and that the economy had been growing faster than 3 per cent for much of 1997.

44. The 1998 Economic Report of the President actually attempted to reconcile the existence of a NAIRU (non-accelerating inflation rate of unemployment) of approximately 5.5 percent with the experience of 1997 when inflation actually fell while unemployment dived below 4 percent (see ibid., 54–63). The council also forecast that the economy would snap back from its “unsustainable” high growth rates of 1996 and 1997 to 2.0 percent from fourth quarter to fourth quarter in 1998, 1999, and 2000 (see ibid., 78–87). The Congressional Budget Office makes a similar prediction:

Despite low unemployment and high output, which CBO estimates exceeded its potential (the amount that can be produced without accelerating inflation), the rate of inflation . . . fell . . . CBO believes that factors such as falling import prices have masked the inflationary pressures that have built up over the past two years. CBO expects that inflation will begin to increase during 1998 . . .

The rise in inflation, together with low unemployment is expected to lead to slightly tighter monetary policy in 1998. Along with the effect of the Asian financial crisis on U.S. exports, an increase of 0.2 percentage points in short-term interest rates is expected to slow economic growth to a sustainable pace by early 1999. (Congressional Budget Office, The Economic and Budget Outlook: Fiscal Years 1999–2008, xvii–xix)

45. See above, pp. 1–2.

46. The federal deficit as a percentage of GDP rose from less than 0.5 percent in fiscal 1974 to 3.4 percent in fiscal 1975 and 4.3 percent in fiscal 1976. By contrast the rise from fiscal 1989 to fiscal 1992 was from 2.8 percent to 4.7 percent. Remember, the key to using the government to raise aggregate demand is in the rise in deficit spending (ERP 1997, 389).
47. The unemployment rate was 5.6 percent in 1974. It fell to 7.7 percent in 1976. Unemployed receiving compensation fell to 67 percent in the same year. For unemployment, see ERP 1997, 346. For the percentage of the unemployed receiving compensation, see 1996 Green Book, 332.


49. In 1974, the Federal Funds rate rose to 10.50 percent. In 1975, the Central Bank pursued a vigorous policy to cut that rate down to 5.82, and the rate continued to fall till the first quarter of 1977. By contrast, in 1991 the rate was only cut from 8.10 the previous year to 5.69. In 1992, however, the Federal Reserve did push that rate even lower; it fell below 3 percent in the last month of that year (ERP 1997, 382–83). See also table W-1 at the web site, <mars.wnec.edu/~econ/surrender>.

50. The rate of growth of real GDP was 5.6 percent in 1976, 4.9 percent in 1977, and 5.0 percent in 1978. In 1979 that rate fell to 2.9 percent. In 1991, the rate of growth was –1.0 percent. In 1992, 1993, and 1994 it was 2.7 percent, 2.3 percent, and 3.5 percent. In 1995 it fell back to 2.0 percent (ERP 1997, 307). For the creation of jobs, see ERP 1997, 340. In 1997 close to three million jobs were created (see ERP 1998, 324), but remember, that is “unsustainable.”

51. For the percentages of the population in poverty see 1996 Green Book, 1226. For the total population receiving AFDC, see p. 467. For the percentage of poor children receiving AFDC, see p. 471.

52. Remember that according to the Reischauer study referred to by the New York Times (Pear, “Budget Heroes Include Bush and Gorbachev”) the Bush changes were more significant than the Clinton changes in contributing to the virtual disappearance of the deficit by the end of 1997.


54. In 1993, the House of Representatives Ways and Means Committee projected federal spending on AFDC for fiscal 1996 at $1.5 billion, approximately 1 percent of all federal expenditures and 6.6 percent of the total federal expenditure on “income security” (1993 Green Book, 679; ERP 1997, 391). In fact the expenditure for fiscal 1996 was actually closer to $1.3 billion, an even lower percentage of the federal budget (1996 Green Book, 459). The projected reductions in expenditures between fiscal 1997 and 2002 as a result of the abolition of AFDC and other aspects of welfare reform come mostly from cuts in SSI and food stamps, not the AFDC replacement called Temporary Assistance for Needy Families (TANF) (1996 Green Book, 1332–33). As mentioned above, some of these cuts have since been repealed. See O’Neill, letter to Raines, 58–61.

55. For investment, see ERP 1998, 280; for the federal deficit, see ERP 1998, 374.

56. ERP 1997, 390.

57. ERP 1995, 359.

58. Federal revenues actually rose as a percentage of GDP in fiscal 1997, a year in which GDP itself grew quite rapidly (see ERP 1998, 373). Federal spending did not quite keep pace with GDP, but total government purchases of goods and services did (ibid., 280–81).

59. Recall that the budget that was passed in 1995 provided for over $1.5 trillion in spending cuts between 1996 and 2002.

60. By its own admission, Congressional Budget Office projections do not
incorporate business cycle impacts on revenue and expenditures beyond the next two years. Thus, in the spring of 1996, seeing no sign of a recession in either 1996 or 1997, they developed their 1998–2006 projections without attempting to estimate the impact of a recession.

[T]he projections are designed to approximate the level of economic activity on average, including the possibility of above-or below-average rates of growth, inflation and interest. CBO uses historical relationships to identify trends in fundamental factors underlying the economy, including growth of the labor force, the rate of national saving, and growth of productivity. The projections of variables such as real GDP, inflation, and real interest rates are then based on their historical norms (Congressional Budget Office, Economic Outlook, 1997–2006, 12).

In 1997, the CBO was able to revise upward their revenue estimates based on strong economic growth so far that year. That also permitted projecting rates of growth of real GDP of 2.2 percent for 1997 and 1998 (Congressional Budget Office, Economic and Budget Outlook, 1998–2007, 1, 12–16). Even these projections proved too pessimistic, and in 1998 they again raised their predictions of real growth for 1998 (Congressional Budget Office, Economic and Budget Outlook, 1999–2008, p. 2).

61. The Emergency Unemployment Compensation Act of 1991 temporarily extended benefits. This act was amended a number of times, and extended benefits ended up being available through October 2, 1993 (1993 Green Book, 521–22).


63. The Clinton Council of Economic Advisers devoted a chapter in the Economic Report of the President for 1998 to “The Economic Well-Being of Children.” They noted that between 1993 and 1996 the number of children in poverty had declined by over two percentage points. However, the chart they present (92) shows that the current level is much higher than before the Volcker-Reagan revolution and isn’t quite as low as it was at the end of the Reagan recovery in 1989. At the end of 1996, 13.7 percent of the entire population lived in poverty, still well above the figures for 1980 and 1988 (320). They also acknowledged that overall inequality has increased since the 1970s (127).

Coda

1. When Professor Vickrey won the Nobel Prize for economics in 1996, he was ecstatic because he believed he could use that “bully pulpit” to present his strong arguments to the general public against single-minded pursuit of budget balance. Unfortunately, he died within a week of receiving the prize, and the public is left only with his writings to support his and others’ position against the current policy consensus. For a summary of his views, see Fifteen Fatal Fallacies of Financial Fundamentalism, October 5, 1996, available on the Columbia University Department of Economics web site at <www.columbia.edu/cu/economics>.


3. There has been a long debate in the specialist literature as to which group
actually controls the behavior of corporations, the shareholders who are the legal "owners," or the managers who carry out the day-to-day activities of the business. See Adolph A. Berle and Gardner C. Means, *The Modern Corporation and Private Property* (New York: Commerce Clearing House, 1932), for the argument that by 1929, a high percentage of corporations were effectively controlled by their top managers. In 1966, in *The New Industrial State*, John Kenneth Galbraith identified the middle-level "technostructure" that, due to its monopoly on the expertise (accounting, marketing, engineering) necessary to make the business run successfully, effectively controlled corporate decision-making. In the discussion of the value to society of a vigorous market for corporate control (see pp. 127–28) the Council of Economic Advisers argued in 1985 that managers are forced to act in the interest of their shareholders by credible threats of outside takeovers. The bishops' view has recently gained significant currency in the literature on the appropriate form of corporate governance, most prominently in the work of Margaret Blair (*Ownership and Control* [Washington, DC: Brookings Institution, 1995]). Blair supports the view that "corporate policies that generate the most wealth for shareholders may not be the policies that generate the greatest total social wealth" (p. 13). This is actually nothing more than a variation on the view that private rates of return and private costs do not always reflect social benefits and costs, a fact acknowledged by the 1982 report of the first Reagan Council of Economic Advisers (see above, pp. 39–41). Blair concludes, as do the bishops, that longtime employees bear significant risks, perhaps more than the shareholders, when they commit themselves to a particular company and should therefore have some say in corporate decision-making (see particularly chaps. 7 and 8).

4. A less benign version of this point is that political and intellectual leaders are very well aware of what the public wants and spend all their time giving the public false impressions of policies designed to help the very richest at the expense of everyone else (how the supply-side tax cuts and other elements of Reaganomics were sold as a way to raise economic growth and employment, when in the end all they did was redistribute income upward) while warning (falsely as well) that the proposals of reformers are "impossible." For an analysis of how public opinion is thwarted by the capture of the political process by big money, see Thomas Ferguson, *Golden Rule: The Investment Theory of Party Competition and the Logic of Money-Driven Political Systems* (Chicago: University of Chicago Press, 1995).

5. Let us recall that when it came to subsidizing business, Reagan was perfectly happy to spend billions on the Star Wars defense system even though the scientists assured the Department of Defense that it would never work, and perfectly happy to force the Japanese to restrain auto exports to protect Detroit producers. Both of these activities overruled "the market" for some "greater good." Recall the summary statement by the editor of *Foreign Affairs* and the argument about the role of the Pentagon in directing investment spending (see chap. 6, n. 76 and chap. 9, n. 18).

6. For an argument that it is, indeed, possible for the economy to grow faster than the 2.3 percent identified in the 1997 *Economic Report of the President* as the long-term sustainable rate (pp. 85–87), see Barry Bluestone and Bennett Harrison, "Why We Can Grow Faster," *American Prospect* 34 (September–October 1997): 63–70. For a contrary view that supports the administration, see Alan Blinder, "The Speed Limit: Fact and Fancy in the Growth Debate," *American Prospect* 34 (September–October 1997): 57–62.

8. One such proposal is contained in National Jobs for All Coalition, “A Growth Agenda That Works: A Program for Sustainable Economic Growth and Development” (available from National Jobs for All Coalition, 474 Riverside Drive, Suite 832, New York, NY 10115, email: njfac@nccusa.org), 27. For their discussion of public capital expenditure, see pp. 8–12.


10. Scott Turow, “The High Court’s 20-Year-Old Mistake,” *New York Times*, October 12, 1997, sec. 4, 15. Turow continues, “As long as politicians must approach the well-to-do on bended knee to secure their chances for election, it is inevitable that the concerns of that narrow segment of the society will have a disproportionate influence on national policy.”

11. The Supreme Court argued that one could not abridge someone’s First Amendment rights in order to assure someone else’s First Amendment rights (see *Buckley v. Valeo*). If this logic were applied to actual speech, an individual who monopolized the floor at a public meeting and continually shouted down the efforts of everyone else in the room to be heard could not be silenced!


14. By January 1864, $449 million of these had been issued. By 1867, greenbacks in circulation represented close to one-third of all currency (Friedman and Schwartz, *Monetary History*, 15–25, especially the table on p. 17). There is nothing mysterious or magical about this process. Instead of creating government bonds that are then sold to banks or the Fed, increasing the Treasury’s accounts with Federal Reserve banks, the Treasury would merely order the Fed to increase their
account balances. The difference is that after the Treasury writes checks to pay
government workers and suppliers and recipients of transfer payments with bor-
rowed funds, the government must allocate interest payments to bondholders,
even if the bonds are merely held by the Federal Reserve System.

15. If these deposits had merely been created without the issuing of a bond,
once the money is spent and circulating in society, the government owes no inter-
est to anyone. Between 1940 and 1946, the national debt of the United States rose
from $42.9 billion to $269.4 billion (1979 Report of the Secretary of the Treasury,
63). Ten percent of that increase is $22 billion. Even a 1 percent interest rate trans-
lates into a saving to the Treasury of $220 million a year through the entire life of
those bonds.

16. See Pollin, “Public Credit Allocation,” 347–48, on ways of preventing
financial intermediaries from evading Federal Reserve control by using foreign-
controlled assets.

17. See, for example, Robert Kuttner, “Managed Trade and Economic Sove-
eignity,” in U.S. Trade Policy and Global Growth, ed. Robert Blecker (Armonk,
NY: M. E. Sharpe, 1996), 3–35. See also Gerald Epstein, James Crotty, and Patri-
cia Kelly, “Multinational Corporations and Technological Change: Global Stag-
nation, Inequality, and Unemployment,” mimeo, University of Massachusetts,
Amherst, February 1997, 30–34.

18. The simplest of these latter proposals has come to be known as the “Tobin
tax,” after Nobel Prize winner James Tobin. The proposal is to place a rather small
(say 1 percent) tax on unproductive speculative security transactions in order to
discourage large movements of funds in and out of particular stocks or particular
currencies just to capture a tiny short-term advantage. Even a relatively small tax
will discourage these highly speculative activities. For the specific proposals to cut
down on destabilizing international currency movements, see James Tobin, “A

19. For the vigorous aggregate demand management of the Ford administra-
tion see pp. 1–2, 255–56. For the expansion of the specifically redistributionist
aspect of federal spending see Michael B. Katz, In the Shadow of the Poorhouse: A
269–82.

20. This later became the basis of ERTA. Much of this story can be traced in
Bartley, The Seven Fat Years, chaps. 2–6. See also Sidney Blumenthal, The Rise of
the Counter-Establishment: From Conservative Ideology to Political Power (New
and think tanks in developing and disseminating the conservative critique of what
Speaker Newt Gingrich later called the “Great Society redistributionist model.”

21. The Economic Policy Institute’s work has been referred to and quoted
throughout this book. The institute is located at 1660 L Street, NW, Suite 1200,
Washington, DC, 20036. Their web site is <http://www.epinet.org>. The Levy
Institute’s work has also been quoted in this book. It can be reached at Blithe-
wood, Annandale-on-Hudson, NY, 12504; the web site is <http://www.levy.org>.
The Center for Popular Economics can be reached at Box 785, Amherst, MA,
01004. Their e-mail address is cpe@econs.umass.edu. The center collaborated with