IRET POLICY BULLETIN

October 23, 1992
No. 58

BUSH SAYS HE'S LEARNED FROM HIS MISTAKES, CLINTON PROMISES TO REPEAT THEM

During this political campaign the one issue that has been of overriding concern to the electorate has been the economy. In spite of this, a statement of guiding principles for economic recovery has not been articulated by either President George Bush or Governor Bill Clinton. What has been sadly lacking is a benchmark that can help the American citizens decide whether any particular policy proposal is a step in the "right" direction. Instead, what the American people are faced with are a set of piecemeal policy proposals meant to solve one perceived problem or another, with no way of judging whether those changes will enhance the nation's economic well-being overall.

This state of affairs is not necessary. It is clear that a system of voluntary exchange based on private property and freedom of choice, i.e., a free market system, will allow an economy to prosper and will enhance the well-being of the population more than any other social arrangement. Indeed, there are very few propositions in the social sciences that are more supportable, either theoretically or empirically, than this one. Furthermore, since our country was founded on a notion of fairness that emphasized individual liberty and responsibility, policies that move the economy toward freer markets also move the society in the direction of a higher moral plane. The economic proposals offered by President Bush and Governor Clinton can and should be judged in this light.

Public policies that are most likely to aid the economy in lifting itself to higher growth rates and enhanced job opportunities will be those that enhance the operation of the free market economy. This means that policies should aim toward allowing markets to operate more freely and toward enhancing not encumbering our system of private property rights. This means different things in different areas of public policy. With respect to taxation and the budget, this implies first that the tax code should do as little as possible to distort the price system and therefore impede economic decision making. Public policy should seek to reduce taxes in all areas but especially on saving and capital investment. This is because the current tax system exerts a strong negative bias in these areas. Therefore growth oriented tax policy would seek to reduce all taxes on dividends and capital gains, all business and corporations, and on ordinary savings.

Institute for Research on the Economics of Taxation

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Over the past decade, and especially since 1986, most changes in the tax code have been inconsistent with this free market approach to tax policy, and consequently have been detrimental to the economy. To some extent, poor performance in real estate and low levels of investment, capital formation, and job creation can all be traced to tax policies that have hampered market activities. Without a doubt, in the area of tax policy the worst thing President Bush and the Congress could have done in 1990 was raise taxes as the economy was moving steadily into a recession.

With respect to the budget, the goal should be to cut spending. This would free resources that are currently being allocated politically through the public sector and allow them to be used more productively in the private sector. Clearly the only meaningful and productive way to reduce the federal budge deficit is through spending cuts. The historical record consistently demonstrates that all new taxes, and then some, go to increased government spending and never to deficit reduction. Beyond this, higher taxes, whether they are on the rich, the poor, businesses, or consumers will have adverse consequences on economic growth, because, by their very nature, they penalize productivity. In other areas of economic policy, the primary question should be, does the proposal lead to freer or more controlled markets?

The analysis in this paper reviews some of the key proposals offered by George Bush and Bill Clinton in light of the free market ideal. To the extent that these proposals lead to a freeing of resources for productive use and allocation by market participants they can be judged as movements in the direction of economic growth and prosperity.

GEORGE BUSH

The Bush Administration frequently takes free market principles into account in the formulation of its policies. But the Administration also considers many other factors, among them political goals and the naive belief that many government programs fail not because they are intrinsically flawed but because they do not have sufficiently capable people managing them. Accordingly, the Bush Administration's statements and actions are eclectic. The Administration sometimes accepts free market solutions, sometimes rejects them, and frequently relegates them to a subsidiary role.

Beginning earlier this year and continuing through the Presidential campaign, George Bush has spoken out forcefully regarding the benefits of the free enterprise system, especially when contrasted with the outcomes that too often result from government intervention. The President describes the "fundamentals of an economic growth [policy as] lower tax rates, limits on Government spending, greater competition, less economic regulation, sound money, and more open trade."[1] During his campaign, he has stressed that the key to a prosperous nation is individual opportunity and enterprise, not government control of production, income, and spending. "Government should not siphon off more economic resources than are absolutely necessary ... My agenda empowers people

[1] *Agenda For American Renewal*, Bush-Quayle '92 General Election Campaign, 1992, p. 7.

with the means to work, own property, build capital, raise families, and be effective contributors within our private market economy."[2]

During the Administration's first term, it strayed from free market principles on several important issues in the tax, spending, and regulatory areas. The President is saying, in effect, that he would place more emphasis on free market policies during a second term. The Republican Platform, which has a strong free-market orientation, supports this position.[3] It is disappointing, of course, that the Administrations's performance the first time around featured more government spending, higher taxes, and more regulations than his 1988 campaign had seemed to promise.

Government Spending

The President criticizes the level and growth of federal spending. "Contrary to the assertions of some politicians and special interest groups, spending as a percentage of the nation's GNP has been going up, not down ... The American Government spends too much."[4] Mr. Bush calls for immediate spending cuts. "I have proposed over $72 billion in specific spending cuts for `mandatory' programs (FY 93-97) ... [and] the outright elimination of 246 specific discretionary programs."[5] He asks why the federal government cannot be "slimmed down" like households and businesses "all across America". Using the Executive Branch as an example, he offers to cut its budget by one-third if Congress does the same with the Legislative Branch and has suggested a 5% pay cut for federal employees earning above $75,000. As a check on overall government expenditures, Mr. Bush advocates a cap on "mandatory" programs, with the major exception of social security, and a freeze on most other federal spending. "I have proposed capping the growth of mandatory spending, other than social security ... [and] proposed freezing all other spending..."[6] If enacted, these proposals would result in the government sector being smaller than otherwise.

In addition to greater immediate restraint, The President advocates fundamental reforms that would permanently inject more discipline into the budget process. He has repeatedly asked Congress for a line item veto. He has fought vigorously for a Balanced Budget Amendment. Because deficit financing hides the true cost of government services, it encourages excessive federal spending. The requirement of balancing the budget would be a good way of restraining those who can always imagine new and expanded federal programs.

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[2] *Agenda For American Renewal*, p. 24.

[3] Republican National Committee, *The Republican Platform, 1992: The Vision Shared; Uniting Our Family, Our Country, Our World* (Washington, DC: Republican National Committee, 1992).

[4] *Agenda For American Renewal*, p. 24.

[5] *Ibid*., p. 24.

[6] *Ibid*., pp. 24-25.

An innovative proposal the President has endorsed is to allow individual taxpayers to earmark up to 10 percent of their tax payments for deficit reduction. In the President's words, "Given the complete breakdown in spending discipline in Congress, it's time that we insist on compensating reforms that give the people a bigger say."[7] The earmarking would have teeth because it would trigger an automatic reduction in spending (through an across-the-board sequester). The tax check-off also has the advantage that it would allow millions of people to participate directly as taxpayers in deciding how much the government should spend.

The Republican Platform reiterates the President's call to action. It charges, "Spending faster than ever, [the Democrat-controlled Congress] blocked Republican reforms that would have saved billions of taxpayer dollars."[8] It mentions numerous curbs on spending that the President recommended but the Congress rejected. The Platform links the budget deficit to the rise in federal spending and much of the added spending to entitlement programs. "Deficits have grown as Democrat Congresses have converted government assistance programs into entitlements and allowed spending to become uncontrolled."[9] The Platform urges that government programs be periodically reevaluated and, if unneeded or ineffective, ended. "When federal programs have outlived their usefulness, they deserve a decent burial."[10] And the Platform warns against the "latest...scam" of using "investment" as "a code word for more government spending."[11]

A relevant question, however, is whether the President would work harder on the spending front in a second term than he did in his first. The Bush Administration has frequently talked tough about bringing federal spending under control. In his 1988 election campaign, the President advocated a flexible freeze that would have held the majority of the federal budget constant in inflation-adjusted dollars but allowed for shifts between sectors. It would have introduced the sort of budget discipline that households and businesses routinely confront and forced those in government to set priorities among programs instead of demanding more for all of them. Regrettably, this excellent idea disappeared almost as soon as the campaign was over and has reemerged (in a somewhat modified form) only recently. The Administration's pledge to hold the line on spending was also undercut by its tendency to add money to various favored programs without making offsetting spending reductions elsewhere and then to brag about the increases. Too often, the Administration has equated larger programs with better government; too rarely, it has pointed to the private consumption and investment displaced by the expansion of government.

After great difficulty, the Reagan Administration, aided by Gramm-Rudman-Hollings, had finally slowed the rise of federal spending to 0.9% per year between 1985 and 1988, although as a

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[7] *Ibid.*, pp. 25-26

[8] *The Republican Platform*, p. 46.

[9] *Ibid.*, p. 55.

[10] *Ibid.*, p. 55.

[11] *Ibid.*, p. 55.

share of national output federal spending was higher in the 1980s than it had been in the 1970s. During President Bush's first term, the average annual growth rate of federal spending in inflation-adjusted dollars was 4.3%. This figure is 1.6 percentage points higher than the growth rate during President Reagan's full 8 years and 0.9 percentage points faster than the growth rate under President Carter. It is much lower, to be sure, than the 7.0% average yearly growth rate registered under President Johnson.[12]

In the 1990 Omnibus Budget Reconciliation Act (OBRA90), the Bush Administration replaced the deficit targets of Gramm-Rudman-Hollings with so-called spending restraints. In reality, many of the spending caps in that agreement had large increases already built into them for the first 1 or 2 years. Further, the agreement contained numerous loopholes, ranging from adjustments for changed economic conditions to "emergency" spending. These loopholes have been used to sanction new spending that would otherwise have run afoul of the caps.

Taxation

The Republican Platform and President Bush have proposed modest marginal tax rate reductions and capital gains relief. If enacted, and if not offset by tax increases elsewhere, these would be steps in the right direction.

During the campaign, Mr. Bush has placed great emphasis on the damaging effects that taxes have on economic activity and on the need to lower taxes in order to get the economy moving again. He says, "Our ultimate success as an economic superpower is dependent on encouraging the entrepreneurial spirit of our private businesses ... You allow people to keep most of what they produce, and they will produce more than they can use, the rest being capital ... When capital is taxed lightly, it becomes abundant. When it is taxed heavily, as it is now, it becomes scarce ... If capital were abundant, labor would become scarcer. And the unemployment lines would shrink."[13]

Among the tax changes Mr. Bush specifically advocates are cutting the capital gains tax and indexing it for inflation, creating enterprise zones, making the R&D tax credit permanent, providing an additional first-year depreciation allowance, establishing a tax credit for first-time homebuyers, and simplifying various tax requirements for small businesses.[14] Mr. Bush suggests that deeper tax cuts are possible, but he would condition them on holding the line on spending. "I will propose to further reduce taxes across the board, provided we pay for those cuts with specific spending reductions ... so that we do not increase the deficit." By way of illustration, he says, "[the] spending reductions I have already proposed ... could finance an across-the-board cut of 1 percent, a reduction

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[12] Office Of Management And Budget, *Budget Of The United States Government, Fiscal Year 1993, Supplement* (Washington, DC: U.S. Government Printing Office, 1992), Part 5, pp. 17-18.

[13] *Agenda For American Renewal*, pp. 14.

[14] See *Ibid*., pp. 14-15.

of the small business tax rate from 15% to 10%, an increase in small business expensing of investment in equipment, and a reduction of the capital gains tax."[15]

At the start of this year, the Bush Administration introduced a "growth package" that contained numerous tax reductions. The net effect of the tax changes in that plan would have been quite modest. Most of the proposed reductions were highly restricted to hold down their revenue cost, many would have been short-lived, and, on the whole, they would have been largely offset by tax increases also contained in the President's plan. Some of the proposals, like the homebuyer tax credit, would have been tax subsidies; they were not directed against preexisting tax biases. Many of the President's current proposals appear to be recycled from that earlier plan. By holding bolder tax reforms hostage to spending restraint, the President may be foregoing the opportunity to push ahead with a more pro-growth tax agenda.

The President urges the nation to reject further tax increases. He rightly cautions that raising taxes "to close the deficit ... won't work ...[it will only] give Congress a license to spend more money."[16] In supporting a Balanced Budget Amendment, he would directly protect taxpayers by requiring a super-majority vote in Congress in order to raise taxes.

The Republican Platform also stresses that low taxes are one of the crucial building blocks for achieving and maintaining a prosperous economy. And it issues this warning, "The simple truth for the American People is this: The only safeguard between themselves and Democrat tax increases is the use of the veto by George Bush and enough Republican votes in Congress to sustain it."[17]

George Bush's most memorable promise in the 1988 Presidential campaign was that he would not raise taxes. Mr. Bush's credibility with respect to taxation was severely compromised in 1990, when he indicated his willingness to consider higher taxes and then later signed onto OBRA90, which included the second largest tax hike in U.S. history. The Administration justified the 1990 tax increase by saying that although it was unpleasant, it was a *quid pro quo* for spending restraint by the Congress. The higher effective tax rates in the agreement worsened tax biases against work, saving, and investment. The stronger tax penalties levied on productive activities slowed the economy. That tax increase and the 1990 payroll tax hike may be the two chief reasons (along with government overregulation of the environment, the work place, and the financial system) why the economy has not regained its vigor after entering what had appeared to be a mild and short-lived slump in 1990. Moreover, when the economic slowdown reduced growth, it thereby generated a drastic shortfall in tax revenues. Meanwhile, the promised spending restraint failed to materialize. Consequently, the budget deficit worsened. This year, the President admitted that the 1990 tax increase was a mistake. He now promises not to raise taxes again — but given the opportunity to make the renunciation absolute, he insisted on retaining some wiggle room.

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[15] See *Ibid*., p. 27.

[16] *Ibid*., p. 27.

[17] *Republican Platform*, p. 48.

Regulatory Policies

Because government regulations deliberately interfere in the actions of producers and consumers, they can greatly slow the pace of economic activity. The tendency is made worse because regulations are frequently complicated and heavy-handed. A nation can reap a substantial growth dividend by keeping to a minimum its regulatory burdens on individuals as producers and households.

Early this year, as part of the Administration's growth initiative, the President announced a limited freeze on new regulations. He has since extended the freeze indefinitely, stressing the losses of production and employment that result from excessive government regulation. Among the President's suggestions with regard to regulatory reform are "a process that subjects regulations to a competitiveness analysis ... and a proposal to `sunset' regulations..."[18] In addition, the Administration is opposing further increases in Corporate Average Fuel Economy (CAFE), and it might be less inclined than Clinton or Perot to raise gasoline taxes or impose Rio-style restrictions on carbon dioxide emissions.

The Republican Platform forcefully lays out the harm caused by government regulations. "Government regulation is a hidden tax on American families, costing each household more than $5,000 every year ... The `Iron Triangle' of special interests, federal bureaucrats, and ... Congressional staff is robbing consumers and producers alike ... We support President Bush's freeze on new regulations ... We call for a permanent moratorium until our regulatory reforms are in place. They include market-based regulation, cost-benefit analysis of all new rule-making, and a Regulatory Budget..."[19] The Platform says on the subject of property rights, "We recognize that property rights are being endangered by government over-regulation ... This under-the-table taxation is unfair, immoral, and economically destructive. We support legislation to require full compensation of property owners who are victims of regulatory takings."[20]

Although the moratorium on new regulations and the promise to be more cautious in the future should give the economy welcome breathing room, the Administration should do more. A host of extremely disruptive regulations were implemented during the Administration's watch, and they ought to be rolled back. The 1990 reauthorization of the Clean Air Act has increased production costs by tens of billions of dollars yearly while reducing emissions by only slightly more than would have been achieved under prior law. The government should have responded to the S&L fiasco by replacing federal insurance with a market-oriented system that charged a risk-related premium. Instead, the legislation it approved in 1989 placed regulatory handcuffs on financial institutions in the form of higher capital requirements and ultra-cautious lending criteria, which many observers believe precipitated a severe credit crunch. The Bush Administration supported these regulatory

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[18] *Agenda For American Renewal*, p. 17.

[19] *Republican Platform*, pp. 50-51.

[20] *Republican Platform*, p. 51.

expansions and continues to praise them. (The Administration has at last taken a small, overdue step with regard to financial institution regulation by adjusting deposit insurance premiums for a bank's financial condition.) A third example is the expansive redefinition of wetlands by the Bush Administration's EPA, which has jeopardized the ability of millions of property owners to develop and improve their land. (In this last case, the White House eventually perceived the regulatory excess and has tried to soften it.)

Mandates

Mandates are a special subcategory of regulations. They usually refer to fringe or other benefits that the government orders producers to give to their employees. The government uses mandates to micromanage the composition of workers' compensation packages to the detriment of both labor and management. If a benefit is highly desired by workers and not too costly to employers, it will be included in compensation without the need for mandates. To pay for mandates, employers will have to reduce other, more valued elements of compensation packages and probably trim their work forces.

With one exception — unfortunately a very big one — the Bush Administration has done well in this area. It has generally opposed mandates and pointed to the perverse results they have on compensation packages and employment. The big exception is the Americans with Disabilities Act (ADA), which the President endorsed and which places heavy burdens on producers regarding handicapped employees and customers. By increasing the cost and legal risks of hiring workers, ADA will depress employment and, when some of the added costs are passed along to customers, it will elevate prices.[21]

Just within the last few weeks, the President acted forcefully when he vetoed a family-leave bill. If he had signed it, it would have destroyed jobs and lowered wages. As the Republican Platform notes, in contrast to the "one-size-fits-all approach" of a government mandate, the free market system has allowed millions of producers and workers to experiment with a much richer menu of options, including "job sharing, telecommuting, compressed work weeks, parental leave negotiated between employer and employees, and flextime."[22] However, the President proposed a compromise that would give a tax credit to employers who allow workers to take family leave. This would complicate the tax code and bestow a tax subsidy on a particular form of compensation. Although the President is correct that a voluntary program would be less damaging to the job market and production than a mandatory one, the government ought not meddle at all in what should be a private decision between producers and their employees.

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[21] The Republican Platform drops an oblique hint that ADA has major, hidden legal and administrative costs when it pledges that it will be implemented "with sensitivity to the needs of small businesses." (*Ibid.*, p. 39.) ADA's potentially high litigation costs and the demands it makes on employers to accommodate the special needs of legally handicapped employees are particularly threatening for small firms. See also, Roy E. Cordato, "The Americans With Disabilities Act," *IRET Economic Policy Bulletin*, No. 45, March 12, 1990.

[22] *Ibid.*, p. 11.

Monetary Policy

The preeminent objective of a nation's monetary authority should be to expand a nation's money supply at a slow, steady pace that is consistent with stable prices. Many governments fall into the trap of trying to speed up monetary growth rate in order to raise real output and employment. But if rapid money growth created prosperity, the richest nations would be those with the fastest currency printing presses. Instead, nations with rapidly escalating money supplies typically suffer from inflation and usually register disappointing real growth because of the disruptions in production that go along with inflation. Sometimes, it is said, monetary policy should be used to fine-tune the economy. But attempts at fine tuning have an uncertain effect on economic activity, may be subject to long and variable lags, and usually degenerate into calls for easy money, which leads to higher inflation down the road. Moreover, the real causes of a weak economy are often high taxes and a heavy regulatory burden. Monetary policy cannot offset these real factors.

The Administration appoints members to the Federal Reserve's Board of Governors, who determine monetary policy. The Administration can also jawbone the Fed regarding the type of monetary policy it would like. The Administration has behaved disappointingly in this area, repeatedly hectoring the Fed to lower interest rates. The rationale is fine tuning: since the economy is weak, a monetary stimulus allegedly should be applied. Whether due in part to the Fed's recent easing or simply the result of a sluggish economy and low inflation expectations, short-term interest rates have fallen to their lowest level in a generation and long-term rates have descended significantly. Yet, production and employment continue to lag, and one must be concerned that the rapid growth of some monetary aggregates may be planting the seed for accelerated inflation in the future.[23]

Trade

Although it is often alleged that the government needs to manage international trade (usually to discourage imports and encourage exports), the truth is that free and vigorous foreign trade strengthens an economy. That helps explain why countries like Albania, North Korea, and Burma that rigidly isolate themselves usually become economic basket cases while countries like most of those in Western Europe and North America that open their borders usually experience prosperity. Although expanded trade may indeed cost some workers their jobs, it typically provides net employment and productivity gains that are far greater. Households that purchase imported consumer goods and businesses that buy imported inputs benefit from lower prices or superior quality (else they would not have bought the imports). On net, free trade tends to increase U.S. employment because U.S. firms buying imports as raw materials or goods for further processing become more competitive and foreigners use the dollars they have obtained to buy U.S. exports or make investments in the United States. It is also found that when domestic firms have to fight

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[23] As discussed earlier, if the problem is a credit crunch, the solution is not lower interest rates for those well-fixed borrowers who can obtain credit but a shift from rigid government regulation to the responsiveness and discipline of a market-based approach.

imports, they become more productive because the added competition keeps them on their toes. If imports were the disasters that many opponents of free trade say they are, countries like Iraq and Haiti that are the targets of embargoes would be brimming with added jobs and production when, in truth, they suffer the reverse.

The Bush Administration has generally been supportive of free trade. It signed a free trade agreement with Canada and has negotiated the North American Free Trade Agreement (NAFTA) with Canada and Mexico. It has put considerable energy into shaping the latest round of the GATT negotiations so as to reduce worldwide trade barriers. On numerous occasions, it has stood up to Congressional demands for protectionism.

In arguing for tariffs and quotas, protectionists frequently charge that some foreign countries have used legal and market barriers to close many of their markets to American products and that the U.S. government should promptly retaliate. Understanding the enormous domestic harm caused by trade wars, the Bush Administration has tried to defuse the charge by laboring, instead, to open foreign markets wider. This is a wise course of action. (The President's trip to Japan was part of this effort but proved embarrassing because of the perception that some U.S. companies were not merely asking for a fair shake but for preferential treatment.)

At the bureaucratic level, however, the Administration has been less successful. Anti-dumping complaints, for example, have become a significant hazard for imports: the rules used to determine dumping are stacked against foreign producers, the costs of mounting a defense are high, and the penalties are heavy. Some of the biggest losers have been American consumers and producers denied foreign products or forced to pay more for them.

The Republican Platform is solidly for free trade. It describes the choice between free trade or protectionism as a decision whether to "compete or retreat ... in the international arena."[24] The Platform also pledges, "We are tough free traders, battling to sweep away barriers to our exports."[25] To the extent this means the Administration will continue in its efforts to lessen foreign trade barriers, it is good. A danger, though, is that this theme may play into the hands of protectionists. The lopsided anti-dumping rules indicate how easily complaints about unfair foreign practices can become excuses for unfair U.S. practices.

Health Care

Several months ago, the Bush Administration introduced a plan for reforming health care in the United States. The plan includes new tax credits (or vouchers for the poor) and deductions intended to improve health care availability, it limits the ability of insurance companies to deny coverage or exclude preexisting conditions, and it places restrictions on malpractice awards. The Administration

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[24] *Ibid.*, p. 62.

[25] *Ibid.*, p. 62.

claims its plan would "build on the strengths of the [current] system – consumer choice, innovation, and state of the art medicine – while controlling costs and expanding access."[26] It says the proposed changes would "cut health care costs by $394 billion over five years through preventive care, malpractice reform, reducing defensive medicine, encouraging enrollment in cost-effective health plans, arming consumers with information ... and eliminating administrative waste and unnecessary paperwork."[27]

Although some of the Bush plan's components appear sensible, the general effect would be to increase the government's role in the health-care market. The Administration insists this would be beneficial because the Administration supposedly knows the proper level of government involvement and how to manage it. This is dangerously overoptimistic. Many of the current problems stem from unwise government intervention. The Medicare program, for instance, has put sharp upward pressure on medical costs and is one of the fastest growing areas of the federal budget and state budgets. Government attempts to limit Medicare costs through price controls have generated an enormous quantity of paperwork, financially strained many health-care providers, and may have caused unnecessary illness and death by arbitrarily denying some elderly patients proper treatment. More government involvement may make matters worse and lead, perversely, to new charges that the market is failing and that the government must do more.

Liability Reform

The essential purposes of a legal system are to safeguard property rights and protect individuals' personal safety. The Bush Administration argues that the legal system has let the American people down on both counts.

In the area of liability cases, the Administration points to a "civil litigation explosion" and a legal system that is "slow, expensive, and putting us at a global disadvantage."[28] For instance, it says, legal procedures are too expensive, the finding of liability is too uncertain and variable, and awards are too high. Legal fees and damage awards are a substantial drain on resources that could otherwise be devoted to production. Under such conditions, producers become overly defensive. They hesitate to innovate lest new products develop unforseen problems that could generate ruinous damage awards or lest new products prove safer than old ones, thereby increasing the odds that courts would hold producers negligent for the design of the old products. Because U.S. firms are more exposed to the U.S. legal system than foreign firms, many observers also believe that liability suits and the threat of them are sapping America's international competitiveness.

Vice President Quayle and his Council On Competitiveness have taken a particularly high profile on this issue. The Republican Platform echoes the same message. They have been greeted with

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[26] *Agenda For American Renewal*, p. 20.

[27] *Ibid.*, p. 21.

[28] *Ibid.*, p. 17.

furious opposition from the legal profession, especially trial lawyers. For the most part Congress has blocked reform in this area.

Most free-market advocates think that damage awards have gotten out of hand. They would agree that the system should be reformed, even if they might not endorse all of the Bush Administration's ideas. The Bush Administration has earned very high marks in this area.

BILL CLINTON

There is one overriding view of markets that permeates almost every aspect of Bill Clinton's proposals in the area of domestic economic policy. While this organizing principle has never been stated by the Clinton campaign nor is it outlined in the Democratic Party Platform, empirically it is the most consistent thread linking together the Governor's proposals. It is the idea that the results generated by freely made choices of producers and consumers acting in a market setting are inadequate; that it is the government's job to define the correct results and then to devise public policies that will induce people to alter their behavior in such a way as to meet those political goals.

While in some areas, eg., the environment and pollution control, Clinton proposes to use certain market mechanisms to obtain bureaucratically determined results, there is no area in which he argues that market activity, unguided by government manipulation, would be superior or even equal to results that could be generated through public policy. In virtually every area from the nature of worker compensation packages to the kinds of R&D that should be carried out and the way many products should be produced, the end result is to be determined politically. At best, markets are a tool for government to manipulate as a way of achieving those results.

This vision is reflected in the Democratic Party Platform, which argues that "economic growth will not come without a national economic strategy." Furthermore, while praising business as a "noble endeavor," the Platform vows to "create a better climate" not for businesses in general but for those that operate only in certain ways, i.e., that "empower their workers, revolutionize their workplaces, respect the environment, and serve their communities well." The government, not the market and not consumers, is seen as the institution that rewards and penalizes business and therefore determines success and failure in business activity. Clinton's fundamental premise concerning the role of business, namely to facilitate a non-economic social agenda, necessarily makes him suspicious of all free market outcomes.[29]

What the market rewards, i.e. low cost, quality production, and what Clinton thinks should be rewarded may in some cases be consistent but very often will be at odds. For example, if Clinton's vision of "revolutionizing the workplace" (however that is defined) is not going to lead to a better final product and make a business more efficient and competitive, it won't be done in an open market

[29] It can be argued that President Bush, to some degree, has also envisioned business in this light, evidenced by his enthusiastic support of the 1990 Clean Air Act, the ADA, the Civil Rights Act of 1990, and increases in the minimum wage.

setting. If such changes are forced onto businesses then they will occur only at the expense of efficiency and competitiveness.

In spite of the fact that the Democratic Platform states that "we believe in free enterprise" and that "we reject the big government theory that says we can hamstring business and tax and spend our way to prosperity," there is no area of domestic economic policy where Governor Clinton does not propose more hands on government involvement than currently exists.

Clinton's Budget: Fiscal Policy as Industrial Policy

Government Spending as Investment

Recognizing the generally negative perspective that the concept of government spending has among the electorate, Clinton's campaign literature and the Democratic Platform refer to their proposed increases in spending as "investment." In order to make up for what the Platform refers to as the "investment gap" Clinton proposes to boost infrastructure spending and subsidize an array of industries, technologies, and products that he feels the freely made investment decisions of market participants are underfunding. These include the construction industry, the transportation industry, information technologies, and environmental technologies. Clinton argues that such outlays represent spending for the future, hence the idea that it is investment. He wants to create a separate category of spending devoted strictly to such future-oriented spending.

The underlying premise — consistent with Clinton's general approach — is that investments made by entrepreneurs tend to be misdirected and short sighted. The role of government budget policy, at least in part, is to second guess the market and redirect investment, through taxes and subsidies, to certain sectors of the economy that the Clinton Administration would deem to be more appropriate. Even though neither Clinton nor the Democratic Platform uses the term, this is industrial policy.

It should be pointed out that Clinton is probably correct in identifying an important economic problem, but his solution completely misses the mark. There is less saving and capital formation in the U.S. economy than there "should" be and much of that investment is relatively short sighted. But this is due to existing government intrusions into capital markets, primarily through the tax system. Through the corporate income tax, the capital gains tax, and the taxation of interest and dividends, the existing tax structure places two, three, or even more layers of taxation on the returns to saving. These tax penalties retard the growth in saving and capital formation and force businesses to seek out projects with a shorter repayment period — i.e. higher yields. Clinton's policies do not address this problem and, because he advocates increasing taxes on those citizens who derive the greatest proportion of their incomes from saving, i.e. upper-income individuals and families, he would exacerbate the problem.

Beyond this, the underlying premise of Clinton's solution is notably absurd. He assumes that political decision-makers and government bureaucrats, who have most often been accused of being able to see only as far as the next election, will be less short sighted in their investment decisions than private sector entrepreneurs. Clearly the burden is on Clinton to demonstrate why this should be the case.

As part of his overall budget plans, Clinton is calling for an increase in "investment" spending of at least $200 billion over a four-year period. This huge transfer of resources from private to public sector control cannot enhance the overall well-being of the economy. Clinton is offering no institutional changes that would suggest that his "investment" would not simply become another special interest feeding trough. It will most certainly enhance the well-being of few at the expense of many. In all the industrial areas Clinton favors, private sector investors are active and should be left undisturbed. As for increasing infrastructure spending, it will not boost GNP so much as displace private sector investment in more valuable plant and equipment.

Taxation

Clinton's proposals are the antithesis of that suggested by the economics of sound tax principles. In addition to raising revenues, Clinton sees taxation as a policy tool for engineering particular results. He proposes to use the tax system to do everything from rewarding and penalizing different kinds of investments to redistributing income along egalitarian lines.

In the area of personal income taxation, Clinton's proposals are driven by egalitarian principles. Arguing that the "rich" have not paid their "fair" share of taxes, Clinton proposes to raise the marginal rate on those families with gross annual incomes of $200,000 or more and to add a 10 percent surtax on those earning over $1 million.[30] There is no basis for such a tax increase on either economic or fairness grounds.

From the perspective of economic growth, tax policy specifically aimed at soaking the rich will have a negative impact on everyone. The income tax is a tax on income-generating activity and will therefore discourage such activity. In a market economy efforts geared toward earning income are necessarily productive activities. Income taxes, therefore, discourage productive activities of all kinds and higher marginal tax rates discourage such activities more than lower rates. Furthermore, as noted above, the income tax is inherently biased against saving and investment activities relative to consumption activities. Any increase in tax rates will discourage productive activity on the part of those exposed to the increase, with saving being particularly discouraged.

From the perspective of the economy there is no distinction to be made between a dollar's worth of productive effort or saving, whether it is generated by a poor person or a rich person. Both generate economic advantages and job opportunities for others and serve to enhance the wealth of society as a whole. Furthermore, progressive marginal tax rates have a disincentive effect with

[30] It should be emphasized that this is gross, not taxable, income. Clinton wants to raise rates on anyone taking in over $200,000 regardless of deductions for business expenses, charitable contributions, etc. After deductions, Clinton's higher rate could apply to those earning considerably less.

respect to upward mobility. If people are allowed to keep smaller and smaller proportions of incremental income, then they will make fewer efforts to secure that income. Because of this, progressive tax rates discourage investments in human capital such as additional education or more specialized training. For any given amount of additional effort or incurred costs aimed at enhancing one's income, progressive taxation reduces the rewards. There is no more basic principle in economics than the simple notion that the fewer the rewards to doing something, the less of it will be done.

The fairness case for Clinton's tax proposal in the area of personal income taxes is also problematic. A sense of fairness that results in policies which penalize success is clearly inconsistent with the ethical heritage of this country. Moreover, in a market economy where economic success is dependent on the extent to which one satisfies the desires of his fellow citizens, targeting those with upper incomes for tax increases is tantamount to punishing those who have proven themselves most capable of figuring out what the wants of others are and then making the efforts to satisfy those wants.[31]

Even if one accepts Clinton's premise, that higher income families should be penalized by the tax system more heavily than others, the claim that the rich have been paying a disproportionately small share of the taxes does not hold up to scrutiny. If fairness is identified by reference to "shares" of total taxes paid by different income classes, the evidence is that the heavily chastised 1980s was a decade of <u>enhanced</u> fairness.[32] Between 1981 and 1990, the share of taxes paid by the top 1% of income earners rose from 17.9% to 25.6%, the share for the top 5% rose from 35.4% to 44.1%, and the share for the top 10% from 48.2% to 55.8% of all taxes collected. On the other hand, the share of total taxes paid by the bottom 50% of income earners during this time period fell from 17.75% to 13.9%.[33] Assuming that he is not being disingenuous, there are two possible explanations for Clinton's position. Either he is unaware of these statistics or he feels that even these dramatic changes during the decade of the 1980s were not enough. If the latter is the case, then it is incumbent upon him to state precisely how much more upper-income individuals would have to pay in order to satisfy his sense of fairness.

Other areas of tax policy demonstrate Clinton's penchant for social and economic engineering. Clinton, like Bush, proposes a cut in the capital gains tax which is a form of double taxation on capital income and should be cut dramatically if not completely eliminated. But Clinton wants to use such a tax cut not as a method for ameliorating the tax code's overall bias against capital

[31] For an extensive discussion of this issue see Roy E. Cordato, "Tax Fairness or Moral Bankruptcy?" *IRET Policy Bulletin*, No. 53, September 6, 1991.

[32] While Clinton has not specifically defined "fair share," even though his campaign literature refers often to the notion, this definition of fairness has been embraced by representatives of his campaign. Specifically, Paul London, a Clinton economic advisor, cited this as the relevant definition, at a candidate policy forum sponsored by IRET in Washington, D.C. on April 29, 1992.

[33] Source: Internal Revenue Service, Statistics of Income Division.

formation, but as a way of promoting certain kinds of investments at the expense of others. In this case he offers capital gains tax reduction for those who make investments in inner cities. Clinton also proposes an incremental "targeted investment tax credit to encourage investments in new plants and productive equipment." An incremental credit does virtually nothing to reduce the overall cost of capital and investment. An administration that preferred market to government allocation of resources would propose a general and not an incremental "targeted" investment tax credit. It is not unlikely that the recipients of Clinton's ITC will simply be those sectors of the economy with the most effective lobbyists in Washington. All of Clinton's tax proposals are of this nature and, even if they weren't inherently wrongheaded from the perspective of economic policy, special interest politics would convert them into nothing more than political goodies.

Clinton proposes to raise taxes on U.S. firms operating abroad to encourage them to invest in the United States instead. In the absence of an improved domestic investment climate, it will not encourage additional investment in the United States. All it would do is reduce investment abroad. Clinton also proposes to collect additional taxes from foreign firms operating in the United States who, he claims, are underpaying their U.S. taxes. The IRS has found little or no evidence of this. These proposals, if adopted, would hurt U.S. firms' competitiveness and would lower foreign investment here, retarding the growth of U.S. productivity, employment, and wages.

Regulation and Mandates: Health Care, Energy, and the Environment

There is no suggestion by Clinton that there is any area where business regulation should be reduced. Furthermore, there are several areas where he advocates massive new intrusions into market activity. Again, the overall approach is one of economic paternalism toward market participants. Instead of taking the approach that impediments to free exchange and entrepreneurial activity should be removed so that efficient solutions can reveal themselves through the dynamics of the market process, Clinton claims to know the correct market outcomes in advance, and wants to use regulation and government mandates to enforce them.

The areas where this is most clear are health care reform, energy policy, and the environment. In the area of health care he defines the problem in terms of costs. Tying health care costs and therefore his policies in this area directly to economic policy, Clinton has stated that "we'll never revive our economy ... until we get health care costs under control." Without referencing the underlying conditions of scarcity and demand, which in a market setting are the underlying determinants of monetary costs, Clinton claims to know, not only that costs are too high, but actually declares what those costs should be. His plan starts with the unsupported assumption that health care costs should "rise no faster than wages," again, with no reference to the underlying conditions of supply and demand. He then devises a set of market controls and mandates meant to achieve this arbitrary goal. His plan amounts to complete government control of how health care is paid for without the outright nationalization of health insurance.

To oversee his plan, Clinton proposes what is called in socialist economies a "central planning board" to oversee the operation of the health care and health insurance industry. This board will establish a "national health budget." The assumption is that the board will know better than market participants how much of the nation's resources should go toward health care and beyond this, what is the best mechanism for delivering health care. The board, in conjunction with state governments, will reorganize health care provision into "health networks" made up of "insurers, hospitals, clinics and doctors" which will receive a fixed budget for providing their services. Furthermore, market determination of insurance rates for insurers not participating in these plans will be eliminated with the national health care board determining fees.

The health care insurance industry would be reorganized such that it will no longer be recognized as "insurance," with its focus on risk assessment, but as simply prepaid health care. All employers would have to provide health care plans as part of all compensation packages and insurance companies would have to insure everyone regardless of preexisting conditions. Charging rates based on the risk associated with insuring particular individuals or groups of individuals would also be banned. This is the equivalent of preventing automobile insurers from offering reduced rates to those with good driving records or those whose cars are equipped with air bags. Price competition among insurance companies would be all but eliminated with fees being established by non-market political considerations. Competition based on service would also be severely limited because Clinton's plan would mandate a minimum number of services that must be covered by all plans. Upon examination, what Clinton is now referring to as "managed competition" in health care is actually no competition at all, but a government managed health insurance and health care cartel. Historically, government created cartels, such as that established for the airlines by the now defunct Civil Aeronautics Board, have benefitted those in the industry at the expense of consumers.

There are many existing market interventions which are causing health care and insurance costs to increase, such as state mandates that force insurance companies to cover treatments and diseases that only a few consumers would be willing to pay for on a voluntary basis. Also driving health care costs is the massive government subsidization of demand through the Medicare and Medicaid programs. And last, but certainly not least, the tort system, which has changed its purpose from rectifying wrongs to the use of insurance companies to redistribute wealth, has caused liability insurance costs to doctors, hospitals, and pharmaceutical companies to skyrocket. All of these factors, plus others, relate to government interventions in the market place that disrupt the normal conditions of supply and demand, causing costs to be higher than they would be in a free market setting. Clinton's proposals and his lack of support for tort reform, suggests that he has no understanding of any of these issues.

Also targeted for extensive increase in regulation by Clinton are the related areas of energy and the environment. Taken as a whole Clinton's plans and goals in these areas would constitute a major reorganization of the way industries operate to produce goods and services. Without any analytical justification Clinton asserts an array of goals that he deems to be in the common good. He then suggests mandates and tax incentives to induce producers to employ production techniques and use productive inputs that would allegedly bring about the desired result.[34]

On issues where scientists have not come to any consensus about whether problems even exist, Clinton wants to institute broad and costly new programs. In spite of the fact that there is disagreement among scientists about whether increased levels of carbon dioxide in the atmosphere will lead to any future global warming problems, Clinton proposes to force consumers and industry to adjust their lifestyles and production methods in such a way that carbon dioxide emissions would be reduced to 1990 levels over the next seven years.[35] This is policy based on public perceptions rather than hard science.

In pursuit of the goal of "energy efficiency" Clinton favors increasing CAFE standards to 40-45 miles per gallon, encouraging investment in renewable resources, increased funding of light rail systems, and encouraging the use of natural gas, among other things.[36] The assumption by Clinton is that energy is being over used as an input to production processes and for other personal lifestyle purposes. No evidence is offered to support this assumption. There is no reason to expect that free markets would not accurately assess the relative scarcities of energy inputs and, through the price system, induce a level of usage that takes these scarcities into account. There is no historical evidence to suggest that free markets have ever failed in this regard. Clinton's anxiety over this issue is simply a reflection of his overall distrust of the results associated with free market resource allocation.

Energy efficiency is not necessarily economic efficiency. The former may over-economize one category of inputs into the production process, i.e., energy. Since other resources would have to be substituted for energy, any government mandated reductions in the use of energy would mean that other inputs will have to be substituted for energy, which would lead to overall increases in production costs.

The focus of all economic policy should be on economic efficiency, which is the minimization of all input costs relative to a given amount of output. If businesses and consumers could increase overall economic efficiency by economizing more heavily on energy inputs, there is no reason to expect that the market and the possibility of enhanced profits would not lead them to do so. Clinton's forced energy efficiency will lead to a reduction in living standards overall.

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[34] See position paper, "Clinton, Gore on Protecting Our Environment," distributed by the Clinton campaign.

[35] See Robert C. Balling, Jr., *The Heated Debate*, San Francisco: The Pacific Research Institute, 1992.

[36] It has been argued that the downsizing of cars to accommodate CAFE standards compromises safety and will lead to 20,000 additional accident deaths over the next decade. See Richard L. Stroup and John C. Goodman, "Making the World Less Safe: The Unhealthy Trend in Health, Safety, and Environmental Regulation," *National Center for Policy Analysis*, April 29, 1989.

Clinton's entire approach to issues concerning the environment follows the industrial policy model. In the area of solid waste, accepting unquestioningly the view that recycling is always good and the use of incineration or landfills is always bad, Clinton wants to establish a program that would force manufacturers throughout the economy to incorporate recycled materials into their production processes. The issue of recycling and how to dispose of solid waste is a resource allocation problem and, as such, is handled best by the private sector following the price signals generated by free markets. In a setting where property rights are clearly defined and enforced, where landfills, incinerators, and the trash collection process are privatized the problem of how trash should be disposed and what resources should be allotted to trash disposal would be solved efficiently. The relative scarcity of land available for use as landfill sites and the relative costs of using recycled and virgin materials in production processes would be reflected in market prices, and resources would be allocated accordingly.[37] The result may not be in accordance with the personal preferences of Bill Clinton or Al Gore, but they would tend to be an accurate reflection of relative scarcity conditions in all of the relevant markets and the preferences of market participants.

In all other areas related to energy and environmental concerns, from the preservation of so-called wetlands to the protection of endangered species, Clinton advocates increased restrictions on human activity. While the slogan for his campaign may be "putting people first," this is clearly not the case in these areas of policy-making. His approach is very judgmental of the free choices that are made by his fellow citizens with regards to their lifestyles, their work and production habits, and the kinds of products they choose to consume. His approach is to use the power of government to change behavior.

Clinton's proposed health care, energy, and environmental policies, if adopted, would result in the near-total politicization of the economy. There is no aspect of the production and exchange process, from employer-employee relationships to the kinds of goods and services that should be produced and the inputs that should go into producing them, that would not have the federal government as an active participant. Unlike the other participants in these processes — consumers, businesses, workers, investors — the government uses coercive means to achieve its ends. Because of this, Clinton's reorganization of the U.S. economy would not only be detrimental to economic growth but it would further erode both property rights and individual liberty. Extending this vision to foreign trade, Clinton's belated support for NAFTA has come with the reservations that production processes in Mexico conform to environmental standards determined in Washington and that job training subsidies be provided for American workers displaced by expanded trade. These caveats would open the door for major increases in quotas and tariffs, which would simply reward special interests and penalize American consumers under the guise of protecting the environment and "helping" American workers.

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[37] The amount of land that would have to be devoted to landfill even if no recycling took place would be very small. It has been estimated that if all the trash that was generated for the next 1000 years were gathered in one place it would require an area of land that is 44 x 44 miles square and 100 feet deep. This is only .1% of the land area of the continental U.S. See Jonathan Adler, "Little Green Lies," *Policy Review*, Summer, 1992.

Conclusion

In assessing the economic policy proposals of President Bush and Governor Clinton, it is clear that neither candidate would significantly move economic policy in the direction of freer markets.

While the President and the Republican Party Platform invoke rhetoric which extol the virtues of freer markets and reduced regulation, they also — inconsistently — reaffirm their support for, and boast about the President's support for the ADA and the 1990 Clean Air Act. The Republicans cannot have it both ways. These mandates represent massive government intrusions into private economic affairs, which by their very nature necessitate an overwhelming regulatory burden on the economy. While the President has correctly admitted that raising taxes was a "mistake," his continued wholehearted support for the ADA and the Clean Air Act mandates suggests that he does not understand the implications of his own pro-free enterprise rhetoric. Repeal of this legislation, or at least significant reform, would go a long way toward reducing the regulatory burden on the economy and enhancing economic growth. It is unlikely, however, that President Bush would take all of the necessary steps in these areas. Bush's tax proposals are small steps in the right direction. If enacted, they would provide some modest benefits. Bolder action is needed.

Clinton's rhetoric and his policy proposals are internally consistent, but would move giant steps in the wrong direction. The Democratic Platform and Clinton's position papers never speak of "freeing" markets or "unleashing" competitive forces. When these concepts are mentioned, it is always in terms of control. Clinton speaks of "harnessing market forces" to deal with environmental problems or invoking "managed competition" to reform the health care system. While proclaiming to be the candidate of change, with respect to the economy he actually is promising to continue and enhance the movement away from free markets that was started toward the end of the Reagan administration and was accelerated during the last four years. If Clinton is elected President and carries out his economic plans, the economy would grow more slowly and be weaker over the long term than it would be otherwise. In a Clinton administration, the economy will be much better off if President Clinton does not live up to the campaign promises of candidate Clinton.

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