Playing with the Numbers

How So-called Experts Mislead Us about the Economy

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ABOUT THE AUTHOR

Richard Stimson's long-time interest in economics began with his B.A. studies at Yale, which included as many courses in economics as in his major subject (government), but it was many years after his graduation with honors (Orations) in 1943 that he did graduate study and teaching in economics.

Meanwhile, after overseas service in World War II, he began a career in public relations that included pioneer work in civil rights and race relations, co-authoring the Connecticut fair employment law and helping obtain similar antidiscrimination legislation in Pennsylvania.

In New York, he ran the tax information program of the American Institute of CPAs for several years. Later as a special assistant to the senior partner of Price Waterhouse, he helped CPAs put their professional advice and explanations into language understandable by non-accountants.

Serving as president of Stimson Associates, Inc., a financial communications firm representing publicly-owned companies throughout most of Florida during the 1970s, marked the culmination of his public relations career.

From 1977 to 1985 he engaged in a second career of university teaching, having earned a master's degree from Florida International University, and studied finance in the doctoral program of the University of North Carolina at Chapel Hill. He taught economics, management, and finance at universities in North Carolina and Connecticut, and in the MBA program of the University of New Haven.

His third career in the 1980s, was in the federal government, where he used his computer programming skills to bring a confused military budget under control, and then became the civilian head of computer operations at a U.S. Naval Hospital.

Playing with the Numbers is his second book, the first having been a family history with the title *Aldens*, *Stimsons*, *and their Kin* (1994), tracing 13 generations from the settlement of New England in the 17th century to their descendents in the late 20th century.

Part One: Miscounting Growth, Efficiency, And Debt

1. WHO ARE THE ECONOMIC EXPERTS?

Some of the leading businessmen and corporate executives of South Florida were gathered for a deluxe meal to hear a speaker who had flown down from New York City. They were the favorite customers of a Florida banking chain which was their host at this event, he was the chief economist of a leading New York bank, and the stock market had recently reached an historic new high.

The speaker predicted that in a matter of months the Dow would double—and he was dead wrong. While almost all the experts then saw the market going up forever, it actually was teetering on the verge of a crash. Soon it plummeted and South Florida was hit harder than most areas in the recession that followed.

This occurred early in 1973, as the Dow Jones Industrial Average broke the 1,000 barrier for the first time, but it is only one example of how Wall Street bulls run riot whenever there is a record high. Similar enthusiasm erupted, for example, after the DJIA reached 9,000 early in April 1998, as there was talk that the Dow would rise to 12,000 in 18 months and double in ten years to 18,000.

In 1973, the outcome was called correctly by only a handful of bearish forecasters, the best known of whom was Eliot Janeway. He said the DJIA would drop to 500 before it would reach 2,000, and he was about right. The Dow closed below 578 in 1974 and did not reach 2,000 until 1987, which was 14 years later than the experts predicted.

In the prevailing euphoria of 1973, economists generally did not expect the widespread unemployment of the 1974-75

recession. Their excuse for being wrong, in most cases, was that unanticipated events occurred, especially the Arab oil embargo and President Nixon's resignation due to the Watergate scandal.

Since life consists mostly of unanticipated events, forecasts and predictions always need to be viewed with skepticism. News media habitually call on Wall Street "experts" to explain daily stock market movements. They sound as if they have three explanations prepared in advance: one if the market goes up, another if it goes down, and a third if there is no change.

Financial analysts can always invent explanations for market behavior, but their predictions are as dubious as those of long-range weather forecasters. While it may be disconcerting when the experts disagree about the economy, it can be even worse when they agree, because often they are all wrong.

Meaningless title

There is no law limiting the use of the term "economist." If a person is a lawyer, CPA, registered nurse, or medical doctor, you have some idea of the training involved, but an "economist" is likely to be anyone who observes and comments on business or market trends. Paul Krugman, then professor of economics at Stanford University and now at MIT, complained in a 1995 article[1] that lawyers, political scientists, historians, and others "cheerfully offer their views" on economics "and especially international trade" in ignorance and contempt for "whatever it is that the [economics] professors have to say."

Krugman's article is one of many reprinted in his 1996 book Pop Internationalism[2] attacking the widely held view that unemployment and declines in U.S. wage levels are due to foreign competition, a subject to be discussed in a later chapter of this book. In his view, "the sources of U.S. difficulties are overwhelmingly domestic, and the nation's plight would be much the same even if world markets had not become more integrated."[3] "The growth of employment is not determined by the ability of the U.S. to sell goods on world markets or to compete with imports," he asserted, "but by the Fed's judgement of what will not set off inflation...."[4]

Another article by Krugman illustrates disagreements among economists and non-economists, pointing to errors by three prominent sources chosen from among dozens of similar cases where the author or speaker was so committed to a viewpoint that "if any data were used at all, it was only to lend credibility to a predetermined belief, not to test it."[5]

People identified in the news media as economists and treated as authorities are most often employees of large banks, Wall Street securities firms, or major corporations, and sometimes "think tanks" that are financed by the same interests and wealthy individuals. Their statements may be clothed in academic jargon but generally reflect the viewpoints of their employers (which may, of course, coincide with their own).

Even government economists and financial speakers are often recruited from the private financial sector. As explained by a veteran of 30 years in the Treasury Department, Francis X. Cavanaugh, in his 1996 book, The Truth about the National Debt: "The economic spokespersons for the various government agencies are usually subcabinet political appointees whose average tenure is only about two years. Their government service is just a brief interruption in a career in industry, banking, academe, or other parts of the private sector. During their terms in office they are expected to echo the views of the president, cabinet members, and other top officials of the administration they are committed to serve."[6]

What about university and college professors of economics? With their jobs protected by tenure we might hope for more objectivity and, in fact, most of the non-orthodox public statements come from the academic world. Tenure has become a weaker protection of independence in modern times, however, as universities make more use of part-time untenured faculty and often decline to renew contracts for faculty who are up for tenure.

Well-established professors like James Tobin of Yale and Lester Thurow of MIT, for example, have taken independent and objective positions that challenge conventional wisdom. Several past presidents of the American Economic Association, including Robert Eisner and Franco Modigliani have made some of the same criticisms of conventional wisdom as you will find in this

book. Some other professors, although probably quite sincere in their views, are unfortunately carried along on the tide of conformity, accepting authoritative declarations by their peers rather than insisting on objective proof.

This is nothing new. As long ago as 1897 the famous author of *Progress and Poverty*, Henry George, complained bitterly about the way most economists rejected his criticisms and proposals without considering their merits: "While a few of these professional economists...resorted to misrepresentation, the majority preferred to...treat as beneath contempt a book circulating by thousands in the three great English-speaking countries and translated into all the important modern languages...."

Had they accepted what he felt he had thoroughly proved, he continued, "it would have converted them and their science into opponents of the tremendous pecuniary interests that were vitally concerned in supporting the justification of the unjust arrangements that gave them power."[7]

The cult of the Federal Reserve

The research positions at the twelve Federal Reserve Banks tend to be filled by people who fit in with the attitudes of the bankers who make up their boards. At the apex of the pyramid is the Federal Reserve Board, whose chairman's words are attended with bated breath by Wall Street. Its members are appointed by the President, but each has a 14-year term that equals three and a half presidential terms of office, and they are further entrenched because their terms are staggered. Although its members never have to answer to the voters and are largely independent of both the President and Congress, the FRB sets the limits on economic growth for this democracy.

The law under which it operates requires it to aim for full employment as well as stability of the currency. The first requirement seems to have been forgotten by these bankers' bankers, who seem to fret at the least hint of inflation but offer only sympathy for unemployment. Raising interest rates when there is no inflation in sight, is what they call a "preemptive

strike." Perhaps pronouncements from the Federal Reserve should be taken with much greater skepticism than is usually applied.

2. FAULTY WISDOM

Economics is an important and valuable field of study, but also it has dangerous weaknesses. Economists worry that their subject lacks the precision and predictability of the physical sciences and try too hard to make up for it. Like others in the social sciences, they tend to worship mathematical cleverness, forgetting the uncertainties that underlie their data. They often seem unaware of a mathematical principle I learned in high school, an extension of the "weakest link" axiom. The result of a calculation can never be any more exact than the least precise of the quantities that entered into it (that is, if a quantity correct to one decimal place is multiplied by another more precise quantity, the answer is still only correct to one decimal place).

A good example of emphasizing math at the expense of the real world from which the numbers are taken comes from the experience of a doctoral student in a seminar at the University of North Carolina at Chapel Hill where students were each to present a critical review of a scholarly paper. The professor gave him a copy of an article by a graduate student at another university that was to be submitted for publication in a journal.

The author of that article manipulated symbols to develop a theory. His complicated calculus may have been mathematically correct, but his assumptions never recognized the difference between commercial banks and thrift institutions. The Chapel Hill student didn't bother to check the math because, as he pointed out, the elaborate manipulations of mathematical symbols were all based on a faulty premise.

The professor, surprisingly, said the student should have "suspended disbelief" and just verified the author's calculus. The article was published later in a professional journal and the author was hired as an economist by one of the twelve regional Federal Reserve banks! The overemphasis on mathematics was the subject of a witty remark attributed to prominent economist Robert L. Heilbroner: "Mathematics has given economics rigor, but alas, also mortis."

As an extension of this kind of thinking, an article, "Math Against Tyranny" by Will Hively in the November 1996 issue of *Discover*, presented physicist Natapoff's mathematical defense of the electoral college, showing that the probability of deciding a presidential election by one person's vote is greater under the existing system than with direct popular election. Natapoff and Hively (like the news media) seem to regard politics as a sport. The more exciting, interesting, and entertaining the better—especially if the outcome can be decided by a lucky shot in the last minute of the final game. Completely ignored was whether the election outcome would reflect the choice of the public as a whole.

The fallacy of "economic man"

Economists, like others who work in their own narrow fields, tend to ignore whatever has been learned in other disciplines, notably psychology in their case. They have invented "economic man" who always acts rationally in terms of his economic interest (this idea having been handed down from a time when women were not thought worth considering). Technically, he makes all choices to "maximize his marginal utility." Having used this concept in their analyses, they don't usually recognize that their results are based on a fiction rather than a real person.

Some of the problems of such a view were well described in an article, "The Limits of Markets" by Robert Kuttner, editor of *The American Prospect*, in the Mar.-Apr. 1997 issue: "People help strangers, return wallets, leave generous tips in restaurants they will never visit again, and give donations to public radio." He could have added that some people choose occupations that offer opportunities for useful service but little in monetary terms.

When the "economic man" concept is criticized, defenders answer by claiming that altruism is a special form of selfishness where the reward comes from enhanced reputation. If countered by the example of those who follow the Biblical injunction to give secretly, they talk of "psychic income," a concept that gets lip service but doesn't seem to fit their equations and models.

By their rules, as Kuttner illustrated, economic theory can even make voting irrational, because the "benefit" derived from

the likelihood of one's vote affecting the outcome is not worth the "cost." Kuttner's 1997 book, *Everything for Sale: The Virtues and Limits of Markets*, summarized the extreme views of Anthony Downs, a leader of the "Public Choice" movement that applies market analysis to political institutions. In *An Economic Theory of Democracy* (1957), Downs argued that the democratic ideal is a sham, because the "median voter" is uninformed and organized groups dominate politics. Kuttner described Downs's work as "pure theory and logical manipulation, in narrative form supplemented by algebra," with "no empirical or historical description of the actual political process."[8]

Another problem is the traditional use of a set of assumptions largely borrowed from Adam Smith's *Wealth of Nations* (1776) that bear little resemblance to today's global economy of multi-national corporations and cartels. Many economists act as if we lived in Adam Smith's world where markets consist of many small buyers and sellers of standardized products, each acting independently with perfect information and no barriers to new firms entering the industry. It is also easy for them to forget the "other things being equal" assumption.

A little trick some economists use is to make their article of faith an assumption and challenge disbelievers to prove them wrong. If they have to admit that their concept is not true in the real world, they retreat to the position that "the economy behaves as if it were true" and again challenge disbelievers to prove otherwise. This saves them the trouble of proving themselves right, but seems rather unscientific.

Yet another problem is the neglect of "externalities," the costs (or, less often, benefits) passed on to outsiders by commercial operations. Such costs include pollution of air and water, exhaustion of natural resources, interference with climate, and creation of traffic congestion. Traditionally, natural resources such as air and water that nature supplies plentifully are treated as "free goods." They are assigned no value, because economists equate value with price. The degradation of air, water, and the general environment are not counted as costs to offset the value of production.

Some of the most important misconceptions in statements of purported experts are concerned with miscounting of economic measures, uncertainty about where tax burdens fall, blind faith in financial markets, bewilderment about foreign trade and currency, confusion that equates a capitalist economy with a democratic political system, and inattention to the superior power of financial and corporate giants over all levels of government.

3. MEASURING GROWTH

Policy choices are often argued in terms of their effect on economic growth. This is measured by production, using statistics that are faulty in ways unknown to most of the public. Conclusions drawn from these measures are also questionable because of the tacit assumption that more production is better for everybody, ignoring adverse effects such as pollution and destruction of natural resources.

It is also worth considering whether increased output is fairly shared. There should be two different measures of the economic well-being of a country: one of the nation as a whole, and the other of inhabitants as individuals or households.

Well-being of the nation

The conventional measure of the nation's economy is Gross National Product (GNP) or Gross Domestic Product (GDP). Although the GDP has become the preferred measure internationally because of the way it handles foreign activities, there is very little difference between the GDP and GNP of the United States under current conditions. What is said below about GDP also applies to GNP.

Since the value of the dollar changes over time, any year-to-year comparisons make sense only when converted into the equivalent value of the dollar of some base year. This is called inflation adjustment, and the resulting measure, called real GDP, is a rough measure of the economic strength of the nation. It is a useful estimate of the nation's ability to build military force and its influence in international trade despite a number of flaws in its calculation, such as:

1. Work done at home by a housewife (including child care) or do-it-yourself improver has value but doesn't count as GDP because no money changes hands. When people who previously did unpaid housework and child care at home change to working for pay, GDP is increased. Any resulting payments they make for child care, transportation, outside meals, etc., also count in the GDP. The shift of many women from the home to

outside work in recent decades caused considerable increases in statistical GDP that did not represent increases in actual output.

2. Where money changes hands "off the books" as in illegal activity or the "underground economy," official statistics miss it. Of course one could say that addictive drugs are harmful rather than useful production, but economic theory, in the absence of a better practical method, values goods and services according to the price buyers will pay.

3. On that same basis GDP includes what is paid for various goods and services of questionable merit—huge and often wasteful military expenditures, cleanup of pollution that could have been prevented, planned obsolescence, and over-staffing of bureaucracies in government and large corporations.

4. GDP ignores costs and benefits to humans and the environment that do not take monetary form in commercial transactions.

Northwestern University professor Robert Eisner, a past president of the American Economic Association, in his 1994 book, *The Misunderstood Economy*, pointed out the distortion caused by a purely market definition of GDP in connection with the movement of women into the labor force, which he said has "greatly increased market output." But he asked: "If restaurant meals are substituted for home cooking, is that an increase in product? If women use part of their market income for commuting expenses, does all of their income properly reflect a net increase in well-being or output?" He estimated conservatively that if the value of unpaid labor services in the home were included the 1992 GDP would have been $8 trillion instead of $6 trillion.[9]

Yale Professor James Tobin and William Nordhaus (both of whom served on the President's Council of Economic Advisors) have developed an alternative production measure that adjusts for unreported production, pollution, and negative results of congestion, but it has not come into widespread use.

Another alternative reported in a 1996 article in *Dollars & Sense* is called the "Genuine Progress Indicator," or GPI, created by the group "Redefining Progress," based in San Francisco.

Clifford Cobb, Ted Halstead, and Jonathan Rowe, the authors of the group's study, explained:

"Much of what we now call growth or GDP is really just one of three things in disguise: fixing blunders from the past, borrowing resources from the future, or shifting functions from the traditional realm of household and community to the realm of the monetized economy." After rising somewhat between 1950 and the early 1970s, they said, the Genuine Progress Indicator (GPI) declined until in 1994 the GPI was 26% lower than it had been in 1973, and on a per capita basis it had fallen 42% since 1970!

Hundreds of economists have called for new measures of economic progress to improve on GNP and GDP. When the Clinton administration entered office, it directed the Bureau of Economic Analysis in the U.S. Department of Commerce to revise the national income accounts. As explained by Eisner, the U.S. government accounts, unlike those of most other developed nations (and budgets of most American states), fail to recognize capital expenditures or investments. The revision was intended to conform U.S. reporting to the guidelines of the United Nations System of National Accounts.[10]

Unfortunately, Democratic Congressman Alan Mollohan of West Virginia, a coal producing state, got funding for the revisions deleted from the federal budget lest environmental revisions to the GDP reflect unfavorably on the coal industry and its tendency to pollute.[11]

GDP remains a useful rough indicator of national economic strength, but its flaws should be kept in mind.

Well-being of its inhabitants

For measuring the economic welfare of individuals rather than the strength of the nation, it is necessary to convert the national measure to the amount per individual, family or household. Otherwise, a nation could double its GDP and its population without anyone benefiting. Such an individual measure is real per capita GDP, obtained by dividing real GDP by the population, and this can be very useful for comparisons over time, although it contains the same weaknesses as GDP itself.

Another such measure is per capita personal income, which is the share each individual receives, on average, of total personal income. The latter parallels GNP and GDP, differing only moderately because of adjustments explained in first-year college economics courses (for example, corporate retained earnings and some taxes are deducted, while Social Security benefits, private pensions, and welfare are added).

A paradox almost always arises during recessions. Wages are stagnant, unemployment grows, and yet the media broadcast and print government reports of increasing per capita personal income. This misleading result can be explained by considering the *average* income of a population of two: namely, billionaire Bill Gates and almost anyone of the rest of us. Take the total, divide by two, and you have an enormous amount. If Gates adds another billion it raises the average but does nothing for the other individual. Rising per capita personal income during recessions reflects the gains being made by a small fraction of the population, which are enough to offset the losses of all the rest and thus bring up the average.

A per capita figure has the characteristics of a simple average (the arithmetic mean), but people's economic well-being depends on how evenly or unevenly the fruits of production are shared in the population. For this reason, the median (that is, the value at the middle of the range, with as many lower instances below as there are higher instances above) is a better measure. It is available statistically in the form of median family income and median weekly wages and salaries.

Another complication is that when a household has more wage-earners and/or people work longer hours, often taking more than one job at a time to make ends meet (as has been happening to an increasing degree), a given amount of real income is not as beneficial as when it came from fewer hours.

Seeking individual and family measures

It is probably best to use GDP, even with suggested improvements, only as a national measure. The economic status of individuals and families is better indicated by median income data.

I have experimented with several possible adjustments to get a more meaningful measure of personal economic welfare:

Adjustment No. 1: Divide the median family's annual income by the percentage of the total population employed. This adjustment makes median family income higher when fewer people work for money wages, very roughly compensating for the failure of official statistics to recognize the value of work in the home. The resulting dollar amount, as shown in Table 1, is useful mainly as an index for year-to-year comparisons. Unfortunately, it fails to measure changes in working hours or changes in family size and composition. Still, it is interesting to see that this adjustment reflects better than official figures the economic squeeze people perceived from the 1970s through the 1990s.

TABLE 1.
MEDIAN FAMILY INCOME
BEFORE AND AFTER ADJUSTMENT

	Median annual family income		
Year	***Nominal dollars**	***Real (1996) dollars**	****After adjustment**
1970	$ 9,867	$37,485	$97,677
1980	21,023	40,079	91,914
1985	27,735	40,443	90,007
1990	35,353	42,440	89,282
1996	42,300	42,300	88,653

***From Table No. 746, 1998 U.S. Statistical Abstract**
****Author's calculation as described in text**

Adjustment No. 2: Multiply median weekly wages and salaries by the percentage of the labor force employed (that percentage equals one minus the unemployment rate). The result tends toward what the median wage would be if zero incomes of the unemployed were included. Using this measure avoids the problem of changing family size. Using constant (inflation-adjusted) "real" dollars, the figures in Table 2 show that workers

made no gains in weekly earnings over that 25-year period, with or without the adjustment. In 1980 and 1985 when unemployment was about 7% instead of about 5% in the other years, real earnings appeared higher than in 1970, but those gains did not hold up after adjusting for the percentage employed.

TABLE 2.
WAGES AND SALARIES OF FULL-TIME WORKERS

	Median weekly earnings		
Year	***Nominal dollars**	***Real (1995) dollars**	****After empl. adjustment**
1970	$130	$480	$456
1980	$261	$483	$449
1985	$343	$486	$451
1990	$412	$480	$454
1995	$479	$479	$452
1997	$503	$465	$440

***From Table No. 696, 1998 U.S. Statistical Abstract (and earlier editions)**
****Author's calculation as described in text**

It would be helpful if median earnings were available on an hourly rather than weekly basis, because news reports reveal that many people are working longer hours to maintain their earnings. Instead of median figures, the government reports average hourly earnings for production or nonsupervisory workers on private nonfarm payrolls. Within this group, unlike a population that includes great extremes of income, the average (mean) is probably close to the median. According to the U.S. Bureau of Labor Statistics, average hourly earnings in constant (1982) dollars, fell from $7.78 in 1980, to $7.77 in 1985, $7.52 in 1990, and $7.39 in 1995, partially recovering to $7.55 in 1997.[12] This gives some indication of overall trends, although supervisory and salaried workers are, of course, excluded, and may be working longer hours for weekly pay that is not increasing.

These results make it rather clear why so many people feel they are working harder for less than a generation ago.

4. FALSE BOOM OF THE EIGHTIES

Politicians have a natural inclination to take credit when things go well, knowing they'll be blamed whenever things go wrong. Whether its Democrats gloating over rosy economic figures under President Clinton or Republicans claiming a period of unprecedented growth and prosperity under President Reagan, neither party faces the realities behind the statistics, such as the decline in good-paying permanent jobs with fringe benefits since the mid-1970s.

Those who point with pride to prosperity in the Reagan administration like to forget about the decline of his first two years and trace changes from 1982 to 1988, his final year. After the severe recession of 1982-83 his remaining years represented a recovery.

Making the comparison more appropriately from President Carter's last year to President Reagan's final year, however, the inflation-adjusted median family income grew 6.7% in eight years from $25,504 in 1980 to $27,211 in 1988, and for the twelve years of Reagan and Bush the gain was 2.2% from $25,504 in 1980 to $26,068 in 1992.[13] Since these figures are before taxes, they fail to show the after-tax effect on middle-income families, who paid more in taxes during this period, as will be discussed in a later chapter.

TABLE 3
BOX SCORE ON THE PROSPERITY OF THE 1980s
(Shown in constant (1982-84) dollars)

Year	Real median[14] family income	Real median[15] wkly.wages & salaries	Federal[16] debt as % of GDP
1970	$25,401	$335	37.8
1980	$25,504	$317	33.4
1981	$24,607	$311	32.6
1982	$24,268	$313	35.4
1983	$24,679	$314	40.1
1984	$25,441	$314	41.0
1985	$25,776	$319	44.3
1986	$26,878	$327	48.5
1987	$27,262	$328	50.9
1988	$27,211	$325	52.5
1990	$27,049	$315	56.4
1992	$26,068	$317	65.1

See tables in previous chapter for figures adjusted by the author for changes in employment levels.

When President Reagan asked for economic legislation in February 1981, a month after his inauguration, he promised a balanced budget after three years and then a surplus.[17] By August 1981 a bipartisan coalition in Congress gave him just about all he asked for in a complex financial package. This included cuts in personal income tax, where the top bracket rate was reduced from 70% to 50% immediately, lesser brackets dropped 5% in October 1981, 10% in July 1982, and another 10% a year later, special benefits for the oil industry were added, and the tax burden on corporations was far lighter in 1982 than it had been in 1980.

Those who received the most benefit from tax cuts could have used their extra resources to create new jobs, but the

incentive to increase production depended on the general public having sufficient purchasing power to buy the resulting goods and services. Instead, many of those who saved on taxes preferred to wheel and deal in corporate acquisitions, leveraged buyouts, junk bonds, ripping off savings & loans and pension funds, and exporting jobs by moving their manufacturing operations to low-wage countries.

Spending cuts were all in the non-military areas. The Defense Department and its contractors were given a blank check (over the objections of Budget Director David Stockman), and a decade of record deficits began. Stockman later admitted using devices like a "magic asterisk" for tens of billions in unspecified future cuts to project deficit reductions "by hook or by crook, mostly the latter."[18] Tight money policy, imposed through the Federal Reserve, kept interest rates high, and would have hurt the economy even more if it had not been offset by deficit spending on the military that amounted to an unacknowledged expansionary fiscal policy.

These economic policies were supposed to overcome inflation and "get America working, saving, and investing again." Instead, there was greater unemployment, savings declined, and investment in research and development dropped sharply in the 1980s. Inflation was reduced partly because the OPEC crisis wound down and partly because of the severe recession.[19]

The claim that Reaganomics brought about prosperity doesn't stand up to the facts. Median income families did not share in the speculative profits of the corporate CEOs, junk bond promoters, and other wheeler-dealers. Junk bonds, so called because of their high risk, were bought by pension funds and savings and loans, leading to some of the biggest financial scandals of the 1980s. Although some supporters claim junk bonds were used to finance growth industries, they have mostly served to finance corporate raids or buy-outs that left the surviving company saddled with enormous debt. How this works is well described in the book (and movie), *Barbarians at the Gate*, about Ross Johnson and RJR-Nabisco, revealing how insiders, speculators, securities firms, banks, and Wall Street lawyers profited in the many millions of dollars.

Trickle-down supply-side economics had not worked in the 1920s when Calvin Coolidge and the Republican Congress slashed the tax rates for the upper brackets, leading to the 1929 stock market crash and the Great Depression of the 1930s. Nor did it work when the experiment was repeated in 1981. Between June 1981 and January 1983, 4.2 million jobs were lost.[20] Unemployment grew from 7% in 1980 to nearly 10% in 1982 and 1983, and the median weekly wage did not recover until 1985 to the 1980 level.

As an indication of how Reaganomics affected different income levels, the money income for the lowest fifth dropped from 5.2% in 1980 to 4.2% in 1993, while the highest fifth increased its percentage from 41.5% to 46.2%, and the top 5% upped its share from 15.3% to 19.1%.[21]

A National Science Foundation study of the amount American companies spent on research and development in the 1980s revealed that R&D expenditures had increased by 5.5% in the first half of the decade but were more than cut in half in the closing years.[22] National production as measured by real GDP grew only 29.7% from 1980 to 1990, compared with 45.8% from 1960 to 1970 and 31.4% from 1970 to 1980 despite OPEC and other crises of the 1970s.[23]

One of the objectives of Reaganomics was said to be increasing the rate of savings by Americans. Even this failed, as savings averaged just 5.4% of disposable income during the 1980s, down from about 7% to 8% in most years of the 1950s, 60s, and 70s.[24] Treasury Secretary Regan's 1981 prediction that the tax cuts would increase personal saving failed dismally. In 1986 Americans saved only 3.8% of their disposable income in contrast to 7.1% in 1980. Government registered negative savings as the forecast of a balanced federal budget by fiscal 1984 failed to be fulfilled. The federal deficit rose from 2.5% of GNP in fiscal 1980 to 5.5% of GNP in fiscal 1986.

From 1980 to 1986, national saving, including both the private sector and the government, declined from 16.2% of GNP to only 12.8%, and net lending to foreigners of $13 billion was reversed to a $144 billion net borrowing from foreigners. America became an international debtor sometime in 1985 and

quickly supplanted Brazil as the most heavily indebted nation in the world. [25]

Nobel Prize economist James Tobin of Yale said of supply-side economics: “What it is sure to do is redistribute wealth, power, and opportunity to the wealthy and powerful and their heirs.”[26] Even Reagan’s Budget Director David Stockman, who had persuaded Congressional leaders in both parties he was the one man who understood the federal budget, finally revealed that supply-side doctrine “was always a Trojan Horse.” Stockman himself explained, “It’s kind of hard to sell ‘trickle down,’ so the supply side formula was the only way to get a tax policy that was really ‘trickle down’ theory.”

As William Greider, to whom he made his confession, put it, Stockman “was conceding what the liberal Keynesian critics had argued from the outset—that supply-side theory was...only new language to conceal a hoary old Republican doctrine: give the tax cuts to the top brackets...and let the good effects ‘trickle down’ through the economy to reach everyone else.”[27] Blinder (1987) described the failure of these policies: “Supply-side predictions that savings, investment, labor supply, productivity, and GNP would all grow rapidly while the budget deficit fell were proven wrong.”[28]

Economist Lester Thurow of MIT wrote in 1992: “I suspect that future historians will also say that America had an oligarchy in the 1980s. The merger wars, junk bonds, business magazines whose biggest-selling issues were lists of the wealthiest Americans, the life-styles of the rich and famous on TV, trade and budget deficits that remain uncured, financial scandals, tax cuts for the wealthy—all are manifestations of an oligarchy....If an oligarchy is redesigning a tax system, it will rig the system so that it pays the least possible taxes. The recommended tax laws will be defended as good for the country, but the prime goal will be tax cuts for the oligarchs themselves. When a public diet is required, the public services that go to the oligarchs will be the last to be cut.”[29]

He noted that the laissez-faire policies of Reagan and of British Prime Minister Margaret Thatcher, both inspired by the monetarist neo-classical economic theories of Milton Friedman,

had failed: "In the U.K. unemployment is higher than it was when Mrs. Thatcher came into office (7.3% versus 5.8%), and the U.K. continues its slow drift down the list of the world's richest countries."

The policies that had been proclaimed as "new" were actually a rehash of the 1920s. Wall Street was as euphoric as it had been under President Coolidge. Journalist Haynes Johnson described it this way: "Rather than promote savings to spur future investment and growth, the evidence was that much of the tax cut revenues of the twenties went directly into the stock market in hopes that individuals would further be able to cash in on the boom. The same phenomenon was at work in the eighties. People were not saving; they were accumulating debt, plunging deeper into the markets, seeking ever-greater personal gains. At the same time, real capital spending, which induced genuine economic growth, was declining. In the end the merger craze and piles of new debt it induced did not improve the nation's industrial capacity and competence. It did not result in overall economic benefit to the nation."

The secret financial crisis

Economist John Kenneth Galbraith predicted in the January 1987 *Atlantic* that eventually the wave of mergers and corporate debt they created would be "regarded as no less insane than the utility and railroad pyramiding and the investment-trust explosion of the 1920s."[30]

That following October the bubble burst as record losses were recorded on the stock exchanges of Tokyo, Rome, Frankfurt, Amsterdam, Paris, London, and New York. On Wall Street, stock market prices had dropped 22.6%, almost double the record losses in the crash of 1929. Most people never realized the extent of the disaster that hung over the New York Stock Exchange and the world's financial system.

Haynes Johnson noted the irony that "what kept '87 from turning into another '29 was the very hand of the federal government that Reagan and the supply-siders had railed against." As the stock exchanges were on the brink of closing down, the

Federal Reserve announced a reversal of its tight money policy and provided funds that enabled banks to extend credit to troubled Wall Street firms.[31]

5. DEFICITS AND DEBT

It would be reasonable to think that the national debt is simply the accumulation of past deficits, but because of government accounting peculiarities it is not true. On February 3, 1998, newspapers printed a photograph distributed by the Associated Press of President Clinton and Vice President Gore flanking a big placard: "1999 Federal Budget Deficit $0! A Balanced Budget." That implied the national debt would stop rising, didn't it?

Not necessarily. I added up the federal deficits for 16 years from fiscal years 1981 through 1996 for total deficits of $3.030 trillion; then I subtracted 1996 national debt from that of 1980 for the 16-year increase in debt and got $4.315 trillion. Therefore, total deficits were $1.285 trillion less than the increase in debt, as reported in the official government statistics. What's wrong here?

The general answer is that this is one of many ways government accounting dishonestly attempts to confuse the taxpayer. More specifically, politicians play games with what is "on-budget" or "off-budget." For example, a bi-partisan tacit agreement kept the public in the dark about the extent of the savings and loan crisis until after the 1988 election and later arranged for the bailout to be off-budget. Costs that never showed up as expenditures in the budget were added to the national debt. Conversely, Social Security tax receipt surpluses reduced budget deficits but added to the debt when government bonds were issued for the trust funds.

The mania for budget balancing

Despite the unreliability of budget measures, a campaign promise is frequently made and broken to balance the federal budget, despite the fact that the public doesn't even know the true size of the deficit. The available figures do not make sense, because government accounting has its own rules. They are so different from generally accepted accounting principles that whenever CPAs do an independent audit of a governmental agency they use special wording much different from a standard opinion.

Capital investment and current expenses are mixed together in government accounting. Also trust funds are mixed in with current operations. No business could operate with such accounting, and it leaves taxpayers without honest information about their government.

Nevertheless, the idea that the government cannot keep borrowing without the same kind of disaster that faces a family living beyond its means is one that sounds like common sense.

In his inaugural address President Reagan declared: "For decades we have piled deficit upon deficit, mortgaging our future and our children's future for the temporary convenience of the present....We must act today in order to preserve tomorrow."[32] Even Franklin D. Roosevelt was elected president on a platform that promised to cut spending and balance the budget. Both Roosevelt and Reagan added considerably to the national debt, whether for good or ill. Presidents Nixon and Carter each reduced deficits but left office rather unhappily.

In a December 1995 column William Safire blamed the "deficit explosion" from $73.8 billion under Carter in 1980 to $290 billion in 1992 under Bush on "House Democrats" whose "spending binge" was "insufficiently resisted by Ronald Reagan," omitting that the president's own proposed budgets were not balanced. On at least one occasion, to force Congress to increase military spending, he refused to sign the appropriations bill and let the treasury run dry. In 1980 the federal budget spent 22.6% on

national defense and 27.8% on what OMB calls "human resources" (excluding Social Security and Medicare). By 1987 the balance had approximately reversed to 27.6% on national defense and 21.6% on human resources.[33]

Alan S. Blinder's 1987 book, *Hard Heads, Soft Hearts*, pointed out that spending other than interest took 20.4% of GNP in 1981 and 20.7% in 1985, making little change in spending relative to GNP, simply shifting it away from civilian purposes toward the military. Total spending authorized by Congress in each year was extremely close to the president's original budget submissions. [See *Wall Street Journal*, Jan. 6, 1987.] "Thus the Reaganite charge that spendthrifts on Capitol Hill caused the budget deficit simply won't wash."[34]

The Gramm-Rudman-Hollings Act in 1985 was supposed to eliminate the deficit on a rigid five-year timetable, but a district court declared the law unconstitutional in February 1986. Before the case reached the Supreme Court each house of Congress passed a budget resolution purportedly achieving the $144 billion deficit ceiling, but President Reagan would accept neither budget, for each raised taxes and cut his request for defense. After the Supreme Court declared the law unconstitutional the House and the Senate, trying to comply with the spirit of the law, compromised on a fiscal 1987 budget supposedly under the limit, but the president balked again on the defense cuts.[35]

By 1992 budget balancing had become a hot issue with third party candidate Ross Perot hammering away at it. Labor Secretary Robert Reich got an explanation on March 18, 1993, from Marty Sabo [D.-Minn.], chairman of the House Budget Committee as to why Congressional Democrats wanted to cut spending even more than the President recommended. "As long as the Republicans were in the White House, the business community didn't talk about the budget deficit," Sabo said. When big business saw Democrats about to take over the White House along with both houses of Congress, he added, they figured they wouldn't get more military spending "and certainly no more big tax cuts for corporations or for the wealthy....Suddenly all they

want to talk about is the national debt." When Reich asked about the Democrats in Congress, Sabo declared: "We're owned by them. Business. That's where the campaign money comes from now. In the 1980s we gave up on the little guys. We started drinking from the same trough as the Republicans...."[36]

The much discussed "peace dividend" after the Cold War ended was elusive. According to Laurence Korb, a former assistant secretary of defense, now affiliated with the Brookings Institution, the U.S. is spending, in adjusted dollars, more on defense today than it did in 1955, or 1975, or most years of the Cold War with the exception of the Vietnam and Reagan peaks. The 1996 defense budget was to be approximately $267 billion, or 85% of average Cold War budgets. Even the right-wing, libertarian Cato Institute questioned the need for today's spending levels. In a July 1995 report, its authors noted: "One of the most tenacious myths, especially among conservatives, is that there has been a dangerously excessive reduction in U.S. military spending since the late 1980s...."[37]

The "Contract with America" of the 1994 "Republican Revolution" that took control of Congress made a major issue of passing a Balanced Budget Amendment to the Constitution. In 1995 the proposed amendment failed to obtain the necessary two-thirds vote. Senator Mark Hatfield (R.-Ore.) cast the only Republican negative vote and was bitterly attacked by members of his own party. Poll results showed that voters favored the Amendment, but only if Social Security were protected. Several Democratic senators were ready to provide the needed vote for the Balanced Budget Amendment on condition only that Social Security trust funds be protected. They wanted them excluded from budget calculations so that future politicians would be prevented from raiding them.

In his memoirs, Robert Reich, who was Secretary of Labor throughout the four years of President Clinton's first term, recalled that on June 13, 1995, President Clinton gave a 5-minute TV address calling for a balanced budget in ten years, saying, "It's time to clean up this mess."

"What mess?" Reich asked, "We've been cutting the deficit for two years running. It's already less than 2% of national output—the smallest of any industrialized nation, the smallest it has been in two decades...."[38]

In the 1996 election campaign both major presidential candidates were promising a balanced budget by the year 2002, and early in 1997 the Republican Congress tried again for a Balanced Budget Amendment. As in 1995, if the amendment were worded to protect the Social Security trust funds, there were plenty of Democratic votes available in Congress to meet the two-thirds requirement, but the Republican leadership would not agree.

Policymakers regularly ignore the 1990 law that restored the separation of Social Security trust funds from the budget. For example, with Social Security excluded, the deficit grew $121 billion from 1980 to 1988, but the government put the trust funds in a "unified budget" to report an increase in the deficit of only $81 billion over those eight years.[39]

The Washington accounting deception that counts the trust funds as part of the budget is dishonest bookkeeping and illegal under Section 13301 of the Budget Enforcement Act of 1990, according to its coauthor, Senator Ernest F. Hollings (D-SC). The bill that Congress passed and President Bush signed into law includes this language:

The concurrent resolution shall not include the outlays and revenue totals of the old age, survivors, and disability insurance programs established under Title II of the Social Security Act or the related provisions of the Internal Revenue Code of 1986 in the surplus or deficit totals required by this subsection...

"That says in plain language they can't use the trust fund to cut the deficit," Hollings observes. "And yet they keep doing it....They call it a 'unified budget,' as though that changes something...."[40]

The 1990 provision was one more step in a continuous effort to correct the treatment of Social Security in the budget. For example, the 1998 *Statistical Abstract*, in a note at the heading of the federal budget summary 1945-1998 (Table 537), states: "The Balanced Budget and Emergency Deficit Control Act of 1985...moved Social Security off-budget."

The unified budget has a long history. A column by Edwin Yoder of the Washington Post Writers Group in 1995 blamed it on Lyndon Johnson in 1967, saying, "Social Security receipts were then running well ahead of outlays, and consolidation of Social Security with other budget categories shrank the apparent deficit then attributable to the cost of the war in Vietnam."[41] My own recollection of the timing is that it occurred during the Eisenhower administration, and this agrees with footnote 4 to the table of Receipts and Outlays of the Federal Government in the *1994 Information Please Almanac*: "Beginning 1956, computed on unified budget concepts; not strictly comparable with preceding figures."[42]

The overall budget was made to look better due to a 1983 increase in the payroll tax for FICA contributions, as recommended by a commission headed by Alan Greenspan, which resulted in a very large surplus in Social Security funds. Since all tax receipts were lumped together, Social Security surpluses were counted as an offset to the budget deficit. Shakelford and Stamos' economics text commented, "Many economists and legislators are upset that a large part of the deficit is being paid by the middle and working classes."[43]

Because the large surpluses in Social security were being loaned to the Treasury and used to obscure part of the deficit, Senator Daniel Moynihan (D-NY) proposed in 1990 to reduce the payroll taxes to a pay-as-you-go basis. Greenspan, as Chairman of the Federal Reserve Board, opposed this and gave the Senate Finance Committee a complicated explanation describing the extra tax money as forced national saving. President Bush talked of the "brink of insolvency" and threats to "bankrupt" the system.

Senator Ernest Hollings (D-SC) declared in disgust: “When you try to stop a raid, they call it a raid. When you try to defuse a time bomb, they say you are creating a time bomb. How, after all this lying, are we going to make ourselves honest?” The Moynihan proposal lost 60-38.[44] In contrast to its handling of Social Security, however, Congress put the savings and loan bailout “off-budget" to hide it from the public.

The interest burden of the debt

For government at all levels, as well as individuals and corporations carrying large amounts of debt, the greatest burden is the growing amount of interest that must be paid. It makes a difference whether debt is incurred for investment or wasteful extravagant living. When people borrow to buy a home or a car or a college education, it is a wise investment, as is business borrowing to build needed facilities.

Unfortunately, government accounting does not tell us whether the borrowing is for investment. Much of the $4 trillion debt inherited by President Clinton had been piled up during the 1980s to pay arms manufacturers for weapons that were not needed and sometimes didn’t even work. The Ames spy case revealed that the arguments for big spending on defense were based on false information from known double agents that was passed on as true by the CIA to policy makers.

Another large part of the debt was incurred to cover revenue lost by the selective tax cuts in the 1980s. Some of the windfall to those who got tax cuts was put into long-term U.S. government bonds. The 30-year government bonds issued in 1953 at 3-1/4% interest matured in 1983 and were refunded at 12%, locking in a high interest rate for three decades.[45] Sadly, those bonds will be costing taxpayers huge amounts of interest for many years to come, and so long as the government honors those bonds nothing can be done about it.

Reich described the accounting problem this way: “The...federal budget...is almost meaningless—an imperfect

accounting device. It excludes future liabilities like federal pensions and veterans' benefits, and it also excludes assets like the value of the federal government's landholdings, buildings, and facilities. Worst of all, it treats all spending the same—whether a crop subsidy to a rich farmer or college aid to a poor kid....

"The GI Bill made college affordable to a whole generation of returning World War II veterans and propelled much of the economic growth of the 1950s and beyond. The expense was justifiable, even though the federal deficit was a much larger percentage of the national output then than it is now...."[46]

How can we balance it—or should we?

It is widely assumed that balancing the budget would be a good thing, but as an economic question it is debatable. When almost everybody agrees, as they did in the Middle Ages about the earth being flat, it may be time to raise questions. The official "unified" budget figures only tell us, more or less, the government's net cash flow. This information is useful mainly to apply Keynesian principles for stabilizing the national economy, running a deficit during a slump and a surplus during a boom. Balancing the budget every year would not be good for America. In time of recession, when tax collections decline and unemployment claims rise, the government would be forced to cut its outlays, making the recession even worse.

Several Nobel prize winners in economics, including Yale economist James Tobin, have declared a balanced budget constitutional amendment would be a dangerous thing. William Vickery, emeritus professor of economics at Columbia University, had he not died of a heart attack a few days after receiving the Nobel prize in economics in October 1996, planned to campaign against "the mania for budget balancing" that he argued was costing people their jobs.

Cavanaugh, an economist who was responsible for debt management in the Treasury Department, has declared (in his

book already cited) that preoccupation with adding to the national debt is misdirected, although, of course, spending should not be wasteful. He added that the notion we are passing on a burden of debt to future generations is a myth. Our grandchildren inherit not only the debt but also the enormous assets of this nation.

He illustrated this point by showing that the federal debt at the end of World War II, roughly equal to defense spending 1942-45, was never paid off. That debt of about $270 billion, plus annual interest at the Treasury's average cost of 6%, is about equal to the $5 trillion estimated federal debt at the end of fiscal 1996. Despite that debt, the U.S. had its most prosperous half-century ever.

The economic burden of the war was borne at the time: no new cars, very limited gasoline, crowded housing and scarcities of consumer goods. Saving the money they couldn't spend, Americans bought government bonds, collectively owing the debt to themselves. If the next generation inherited debt, it also inherited those same bonds and the nation's vast assets, including the freedom their parents bought for them with sacrifices of lives as well as material goods. Cavanaugh proposed a "program budget" that would exclude interest payments because they are uncontrollable and focus attention on spending and taxes instead.

The idea that national debt is a burden was listed by Dr. E. J. Mishan of the London School of Economics and Political Science as Number 5 of "21 Popular Economic Fallacies" in his 1969 book of that title. He quoted former President Eisenhower, criticizing President Kennedy in 1963: "In effect, we are stealing from our grandchildren in order to satisfy our desires of today."

Mishan countered that government borrowing does not change the amount of real goods and services produced. "Real capital can be passed on to the future, but there is no way of getting real capital from the future!...If the present generation consumes more of its income the level of consumption will grow less in the future....To call this a burden on future generations makes no more sense than to call the opposite a sacrifice of the present generation. Both terms are meaningless without an agreed norm for the path of consumption over time."[47]

Another author has pointed out that budget balancing could be hazardous to our national economic health. Frederick C. Thayer, professor emeritus at the University of Pittsburgh, wrote in the Jan..-Feb. 1997 issue of *The American Prospect* that all six major depressions in the U.S. came after budget surpluses and reductions in national debt. There has been no depression since the Great Depression of the 1930s, and all nine recorded recessions since World War II have immediately followed deficit cuts relative to GDP.

6. SOCIAL SECURITY AS SCAPEGOAT

Social Security has been included among the human resources categories of government spending blamed for federal deficits. Powerful interests trying to deflect budget cuts from their own favorite items have deliberately created confusion in this area. They have used "entitlements" as a code word to raid Social Security, despite its popularity as one of the most successful government programs especially helpful to middle and lower income groups. Although other items such as Medicaid for the poor and various welfare programs fall into the budgeteers' category of "entitlements," they are quick to point out that Social Security and Medicare are the largest items.

Cavanaugh, having tackled conventional wisdom about the national debt, also pointed out that Social Security "has nothing to do with federal deficit or debt. The trust fund is fully invested in the safest securities in the world. The welfare of future retirees depends on the productivity of workers in the future, based on present care to the health, education and welfare of today's children."[48]

Social Security is a contributory pension plan, also helping widows, orphans and disabled persons. Just as corporate raiders have diverted employee pension funds, some editors and politicians would like to defraud those who have paid Social Security contributions all their working lives. Military pensions likewise have been earned. They were promised for service to our country, often hazardous and usually at much less pay than civilians. When the fighting is over, "Support Our Troops" becomes a less popular slogan. Pensions of civilian government workers were part of the terms of their employment, so it would be dishonest to default on them. (There seems to be no movement to limit the over-generous pensions and other benefits enjoyed by ex-presidents and ex-members of Congress.)

It is wrong for editors and politicians to lump these earned pensions in with welfare programs under the catch-all phrase "entitlements." On the other hand, such handouts as farm price supports and various business subsidies, although unearned, are generally omitted from the attacks on "entitlements," unlike the Social Security and military pensions that have been earned by contributions and service. Deposit insurance, to the extent it exceeds payments by depositors and/or the financial institutions, is another subsidy that has not been earned and is seldom included in attacks on "entitlements." Apart from what budget analysts call entitlements, there are other expenditures that are similar in that they tend to grow spontaneously, such as multi-year military contracts, but they also escape examination in these debates.

Even Lester Thurow, the MIT economist who is sound on so many other points, has joined the intergenerational war-mongers denouncing the elderly as robbing the young. Citing the 41% of their income received "from government" by those over 65, he brushes off the life-long payments they made into trust funds, and declares flatly, "This...has made the elderly into one-issue voters [on] pension payments or health care benefits."[49]

Leading the propaganda effort to turn youth against their grandparents are organizations largely funded by the financial community, which has its own profit interest in privatizing Social Security. Of course, it is legitimate from time to time to adjust the system as needed, and this has been done over the years. For example, on January 20, 1983, a blue-ribbon commission headed by Dr. Alan Greenspan, then president of an economic consulting firm and later named Chairman of the Federal Reserve Board, reported that things had not gone well since President Carter and the Congress made changes "guaranteeing" the solvency of the system in 1977. The commission presented recommendations to eliminate shortfalls through 2056.[50]

By January 1997 new predictions based on different assumptions advanced to 2029 the date the trust funds would run out. The Advisory Council on Social Security reported a split opinion of three different solutions, varying chiefly in the extent to which Social Security contributions would be diverted from government bonds to the stock market.

In the many discussions of the problem, nobody seemed to remember that Congress drained the trust funds in the election year of 1972. They made a "miscalculation" doubly compensating for inflation (which change was phased out by 1977 legislation, but people born before 1917, including many of the politicians who made the "error," continued to receive the bonus). This was the basis of the "notch" controversy that reached a peak in the 1980s. Without that error the trust fund would show an even greater surplus.

Although warnings about the effect of baby boomers retiring have emphasized the declining ratio of workers to pensioners, Robert Ball, former Social Security commissioner, and Henry Aaron, director of economic studies at the Brookings Institution, maintain "the true measure of the burden of the dependent population is the ratio of the dependent, old and young, to active workers....The dependency burden will never be as high as it was in 1960, when the baby boomers were children [904 per 1000 active workers vs. 707 in 1993, 656 in 2010, 789 in 2040, and 826 in 2070]." Economist Frank Ackerman quipped: "If we could afford to live through the childhood of the baby boom generation, we can afford to live through their retirement."[51]

Six members of the sharply divided Advisory Council on Social Security reported in January 1997: "Social Security is not facing a crisis. The program, as currently structured and financed...can pay full benefits for another 30-plus years....Even 75 years from now, current-level taxes would cover about 70% of the cost of the program." As he quoted them, Robert Reno of *Newsday* added his comment: "There is also the possibility that the system may not need fixing at all. Predictions of a Social Security deficit in 30 years are based on the guesses of the system's trustees, a body that is paid to be super-cautious."[52]

Scare stories about the system crumbling in the future are based on very iffy projections. Should the economy regain the health it lost since the mid-1970s, many problems would disappear. Nevertheless, putting Social Security reserves to work in the private sector might be a good idea, if it were done along the lines of the successful Thrift Savings Plan for voluntary stock and bond fund investing by federal employees.

In 1986 the Congress authorized stock index fund investments (without voting rights) by the Federal Retirement Thrift Investment Board, which administers the Thrift Savings Plan for federal employees. Cavanaugh, who was the first executive of the board, wrote that they "encountered no significant problems as we selected an index (the S&P 500), obtained competitive bids from large index fund managers, and established a highly efficient stock fund with minimal administrative expenses. I see no reason why the Social Security trust fund should not have the same stock investment advantage as the Thrift Savings Plan."[53]

That, of course, would not generate the huge commissions sought by the lobbying effort of Wall Street (in league with the Cato Institute, the National Center for Policy Analysis, the Institute for Research on the Economics of Taxation, Third Millennium, and the National Development Council) to get its hands on everybody's FICA contributions.

Eisner saw irony in the efforts of capitalists to have the government trust funds invest in the private sector. He saw the possibility it might be carried far enough to "leave us with an economy in which public ownership—by the government trust fund—would replace the private profit, private capitalist system....Are advocates of using the trust funds to 'invest' in other than government securities really closet socialists?"[54]

Another suggestion by some politicians and commentators has been a "means test" applied to Social Security. That is, a government-defined level of poverty would be a requirement to receive benefits. For the sake of cutting benefits to those who, by diligence or luck, have private income in retirement, there would be a means test that would require a vast bureaucracy to pry into the financial affairs of every beneficiary. It seems to me the cost of this effort might easily offset any reduction in benefit payments. Certainly it would undermine the original purpose of Social Security, which was to let the elderly keep some dignity and self-respect instead of suffering the humiliation of private or public charity. Some have also proposed a means test for military and civil service pensions. In that case the government would be going back on its word like the private

sector employers whose pension scams brought about government regulation.

Another proposal affecting Social Security involves the Consumer Price Index (CPI). Politicians trying to cut Social Security, military pensions, etc., have been floating the theory that the CPI exaggerates inflation. This deserves further discussion in another chapter on inflation.

7. WHOSE WELFARE?

Welfare reform was a powerful political slogan offered as a remedy for federal deficits. Nothing gets some hard-working people so upset as the thought of others living a life of idleness from government handouts. Many of them know someone, perhaps a relative, who seems always to be on welfare. Then they shop in a supermarket and look for bargains in less expensive food, only to reach the check-out counter behind a well-dressed customer who pays for a shopping cart full of steaks with food stamps and then drives away in a luxury car.

While some such perceptions may be faulty because of lack of full information, most of them are probably correct and lead to resentment that is justified. That resentment has been fanned by political propaganda. Typically, the charge is made that taxes are high because the budget is bloated with entitlements—a. budget planning category that campaign rhetoric has turned into a term of derision. Social Security does not belong in this discussion because it is self-financed and the revenues from workers and their employers have always exceeded the benefits paid out each year.

In 1980, when poor mothers receiving aid for dependent children were being denounced as "welfare queens," welfare made up much less of the budget than people thought. Total federal outlays, after excluding Social Security, amounted to $472 billion. The "income security" category of $87 billion included $27 billion of federal employee retirement and disability that should not be considered welfare. Taking that out, there was $60 billion of what might properly be described as welfare.

Bottom line: all these "income security" items, including housing assistance, food and nutrition, aid to families with dependent children (AFDC), unemployment benefits, etc., added up to 12.7% of federal outlays (net of Social Security) in 1980. For comparison, it was 27.7% for the military, 15.8% for interest on the public debt (mostly incurred for past wars), and 7.4% for

agriculture.

In 1994, when Republicans captured the Congress, welfare outlays as defined above were 13.3% of federal outlays (net of Social Security), military 23.5%, interest on the public debt 26%, and agriculture 5.3%. This information is calculated from the figures in Table 522 of the *1995 Statistical Abstract of the U.S.* The welfare amount of about 13% is hidden from the public by the continued government use of the "unified budget" despite the previously described Budget Enforcement Act of 1990.

The pie charts printed by the IRS in its 1997 tax instructions showed a total of 56% of federal outlays in the entitlements categories (38% for Social Security, Medicare, and other retirement plus 18% for social programs) with only 20% for "national defense, veterans, and foreign affairs" and 15% interest on the debt.

Likewise, pie charts of the proposed budget from the White House for 1999 showed 53% for entitlements (35% Social Security and Medicare plus 18% other), 15% for defense, and 14% for interest. This improper "unified budget" approach is seriously misleading and loads the dice against payments that go to poor and middle-income individuals and families. It provides ammunition for the conservative organizations sponsored by corporations and wealthy individuals.

The benefits bestowed on corporations by the government are not conveniently grouped in the budget like the ones that are usually thought of as welfare. Their general extent, however, can be judged by some examples, drawn mainly from the best selling 1992 book, *The Government Racket: Washington Waste from A to Z* by Martin L. Gross, which altogether lists possible savings of $225-340 billion, as I add them up.[55]

Much of the saving targeted by Gross has to do with general inefficiency of operation, of which I have some first-hand knowledge. As a civilian financial officer at a Navy installation, I learned that Navy accounting (and government accounting in general) is structured in a way that no private enterprise (nor its auditors) would tolerate, perhaps in a deliberate attempt to confuse outsiders, certainly confusing to those inside the system.

You might think that a commander would get a pat on the back for giving money back to the taxpayers. Not so. A national training program in the military urged spending at least 99% of the budget one way or another, to avoid unspent appropriations leading to the conclusion that "if you didn't spend it you didn't need it, so we'll give you less next year."

Waste permeates government at all levels, but I've seen dedicated and capable employees in federal and state government who are powerless to reform the system. Gross claimed waste of $68 billion annually in excess overhead, mostly hidden in the $170 billion "other services" category. Regarding the $56 billion agriculture budget, Gross noted that while farms and farmers had declined to one-third in 50 years, with half the farmers becoming part-timers, farm bureaucrats had multiplied threefold. He projected that by 2040 there would be one Agriculture Department worker for each full-time farmer.

Corporate welfare

Other leakage listed by Gross includes some large items ending up in private pockets, such as:

- $20-40 billion annually estimated cost of Medicare fraud that could be recovered by tougher administration.
- $32 billion worth of cellular phone licenses alone have been given away but those for pocket phones could be auctioned off for many billions, if not given away by the FCC for nominal fees.
- $30 billion in agricultural subsidies, that also cause consumers to pay higher prices. Although a 1980 law supposedly limited payments to $50,000 per individual, Gross concluded "that the largest and wealthiest of farmers continue to receive the major harvest of taxpayer money."
- $10-20 billion in subsidized interest and write-offs of loans by the Farmers Home Administration under the Agricultural Credit Act of 1987. Although some part of agricultural outlays benefit small family farms, the

overwhelming bulk of the expenditures go to subsidize corporate agribusiness, which has come to dominate farming in the United States.

- $5 billion of new construction and $2 billion to lease office space instead of using the 15 million square feet of vacant space in federal buildings and moving government employees into dozens of military installations being closed down, as suggested by a government auditor. The money goes to construction firms and owners of leased space, as well as $100 million for non-government buildings at private institutions, such as universities.
- $5 billion of consulting contracts, about most of which government agencies lied when GAO auditors investigated. In fact, the spokesman for the Senate committee behind the audit said it could be as much as $20 billion.
- $3 billion paid to banks for defaulted student loans and almost $3 billion in interest subsidies, "even though the banks take absolutely no risk."
- $2.3 billion operating loss of the Export-Import Bank, plus default losses, on subsidized low-interest loans to foreign companies who buy American exports.
- $2 billion annual deficit of the Forest Service selling timber below cost and building roads for wood-products companies to get access to bargain timber.
- Huge losses of public assets in the form of land not showing up in the budget due to the Mining Law of 1872 that still allows sales at $2.50 per acre. Gross cited one parcel sold by the Interior Department for $42,500 that was resold a few weeks later to an oil company for $37 million.
- Nearly $1 billion for the Small Business Administration which loans not to really small businesses but to those that typically gross $1 million or more with very good cash flow. In 1990 and 1991 SBA subsidized almost a half billion dollars of loans

to prosperous doctors, dentists, lawyers, accountants, and other professionals.

- $3 billion excess cost in each census year because of gathering data useful mainly to industry.
- $200 million for advertising agricultural products overseas, including ads for Sunkist citrus, Blue Diamond almonds, Gallo wines, Pillsbury, Dole, Welch's, Wrangler blue jeans, Tyson chickens, and McDonald's hamburgers.

More corporate welfare

ABC-TV news has reported other waste, such as $1.2 billion for VIP planes and supplemental Defense appropriations the Pentagon says it doesn't need.

Budget experts quoted by Common Cause estimate that federal corporate welfare payouts will amount to $265 billion over the next five years—averaging $53 billion per year.

Besides direct subsidies, there are also the special tax benefits that have made the tax code such a monstrous maze.

Another handout cited by Common Cause is the $70 billion gift of the digital broadcast spectrum free of charge to the broadcast industry instead of subjecting it to auction.

The Democratic Leadership Council (DLC), the most conservative group in the Democratic party, published, in 1994, a list of unwarranted tax breaks and subsidies for particular companies and industries, totaling more than $100 billion a year. As described in his memoirs by Labor Secretary Robert Reich, they included "$2 billion a year going to oil, gas, and mining companies for no reason whatsoever, $4 billion a year to pharmaceutical companies that create offices in Puerto Rico, $400 million to Christmas-tree growers, windmill makers, and shipbuilders, and $500 million a year to corn-based-ethanol refiners.

"Also...the $2-billion-a-year tax break for the insurance companies, $900 million for timber companies, $700 million for the dairy industry, and $100 million a year to large companies for advertising abroad. On top of that are billions of dollars of special

breaks for multinationals that make their products outside the United States....

"If private corporate jets had to pay landing fees at airports as commercial jets have to do, they'd pay $200 million a year. If wealthy ranchers had to pay the full cost of grazing their cattle on public lands, they'd pony up $55 million a year. If corporations couldn't deduct the costs of entertaining their clients—skyboxes at sports arenas, theater and concerts, golf resorts—they'd pay $2 billion more each year in taxes."[56]

Warren Buffett, himself a billionaire, has called such benefits "food stamps for the rich."[57] Corporate welfare makes "welfare queens" look like pikers.

Part Two: Nonsense About Taxes And Income Distribution

8. THE ILLUSION OF TAX CUTS

Politicians and editors, even those opposed to the tax changes of the 1980s, routinely and unthinkingly refer to the "Reagan tax cuts." This is a huge misconception because, except for the upper brackets and corporations, there were no overall tax cuts. While the percentage of the national economy (GDP) taken by federal taxes dropped slightly (19.2% in 1980 to 18.7% in 1990), that is only part of the tax burden. The federal government continued to mandate state and local programs, while cutting down its revenue sharing. This shifted the burden to more regressive taxes: state sales taxes, local property taxes, and miscellaneous charges and user fees.

TABLE 4.
PER CAPITA TAXES

Fiscal Year	Total tax--Fed. state & local Nominal	Real	Federal taxes Nominal	Real	Fed. % of Total
1980	$2,535	$3,076	$1,548	$1,879	61%
1990	4,558	3,487	2,542	1,945	56%
1994	5,401	3,644	2,998	2,023	56%
1995	5,728	3,759	3,214	2,109	56%

Source: 1998 Statistical Abstract of the United States, Table 499. Real (constant) dollars are stated in terms of 1982-84 purchasing power.

In 1982-84 constant dollars, as shown above, per capita total federal, state and local taxes rose 13% from $3,076 in 1980 to $3,487 in 1990. Of these totals, the federal share dropped from 61% to 56%. There were really no Reagan tax cuts, only a shift in the burden from federal to state and local governments and from

upper-income to middle-income taxpayers. Parenthetically, figures for 1995 (the most recent available) show a further 8% total tax increase in only five years and no change in the federal share.

Kevin Phillips, who had been the chief political analyst of Nixon's 1968 campaign, declared President Reagan emulated the Harding-Coolidge era when he "cut top individual rates from 70% in 1981 to just 28% as of 1988-1988—effectively matching the 1921-25 reduction from 73% to 25%."[1] Although Democrats and Republicans in Congress voted for the tax revisions, they are usually credited to the President because the bills were enacted on his watch, with his approval, and signed by him.

The infamous "Laffer Curve"

These changes were supposed to help everybody. The argument is that reducing upper-bracket taxes gives those whose taxes are lowered more incentive to work and to save, which will increase national production, and "a rising tide lifts all boats." There is not supposed to be any loss of tax revenues because previous high rates were assumed to have reduced incentive, so cutting the rates would cause people to make more money and pay more taxes even at lower rates. The key to this argument is the so-called "Laffer Curve."

Prof. Laffer used to doodle on napkins in restaurants, drawing a curve shaped like a mountain that was supposed to represent the amount of revenue from income tax. At the left where the tax rate was zero the revenue would, of course, be zero, and at the right where the tax rate was 100% (so that nobody could earn any income without the government seizing it all) the revenue would be zero also. The peak of the mountain represented the point where increasing the rate would so discourage effort that revenue would decrease as rates went up.

Laffer persuaded Reagan that rates were already beyond the high point of the curve so reducing rates would bring in more revenue by climbing backwards up the mountain. Unfortunately, a four-trillion-dollar national debt had been amassed at the end of the trial. This seemed to have convinced most experts that Laffer was wrong, but some apologists for the deficit years of the 1980s keep claiming it works. In the 1996 vice-presidential TV debate

Jack Kemp repeated the claim that tax cuts boosted tax revenue to the government. Tax receipts did rise during the 1980s, but the claim ignores inflation and fails to compare with a base period.

To measure changes over the years we need dollars of constant purchasing power—inflation-adjusted dollars economists call "real." Raw amounts not so adjusted are called "nominal" and politicians use nominal figures when it serves their purposes. "Figures don't lie, but liars figure." Total receipts, used by some debaters, are irrelevant because they include Social Security contributions (FICA) and various receipts other than income taxes.

The record is as follows:

TABLE 5
FEDERAL INCOME TAX RECEIPTS

Fiscal year	1990	1980	1970	1960
Individual income tax				
nominal	$466.9	$244.1	$ 90.4	$40.7
real	357.2	296.2	233.0	137.5
Corporate income tax				
nominal	93.5	64.6	32.8	21.5
real	71.5	78.4	84.5	72.6
Total income tax				
nominal	560.4	308.7	123.2	62.2
real	428.8	374.6	317.5	210.1

Note: Real amounts in constant 1982-84 dollars adjusted for inflation by the Consumer Price Index (CPI). All amounts except CPI in billions of dollars.[2]

Individual income tax receipts rose 91% in nominal terms during the 1980s, but only 21% in real dollars. Corporate income tax receipts rose nominally 45% but actually declined 9% in real terms.

Even in nominal terms, receipts from income taxes of individuals and corporations rose only 82% during the 1980s, compared to 151% in the 1970s and 98% in the 1960s. After correcting for inflation, they grew only 14% during the 1980s, compared to 18% growth in the previous ten years and 51% in the

1960s. Thus Kemp's claim was wrong regardless of whether nominal or real dollars are compared.

Proponents of the "Laffer Curve" approach, were fond of citing the successful JFK tax cut to prove their point. In January 1963, President John F. Kennedy proposed to Congress a reduction in individual income tax rates from 20% to 14% at the bottom and 91% to 65% at the top, while the corporate rate would drop from 52% to 47%, with special reductions for small business. Ironically, the Republicans on the Ways and Means Committee opposed the Kennedy tax reduction as fiscally irresponsible.

Eventually, after Kennedy was assassinated and Lyndon Johnson became president, a bill along these lines was passed. Virtually all the econometric studies agree that it was highly stimulative to the economy. Because of that, and earlier Kennedy policies, unemployment dropped sharply between 1961 and 1969, especially for adult black males whose unemployment went from 11.7% to 3.7%.

In 1977 Walter Heller testified..."the tax cut...was the major factor that led to our running a $3 billion surplus by the middle of 1965 before escalation in Vietnam struck us...." Bruce Bartlett of the Congressional staff in his 1981 book commented: "It is ironic that the most important reduction in tax rates since the 1920s was accomplished by a liberal Democrat for decidedly liberal reasons—to pump up demand....The economic record is clear: the period following the enactment of the Kennedy program is the best this country has had in the last quarter century."[3]

9. BEWARE OF TAX REFORM AND SIMPLIFICATION

President Carter recalled in his memoirs the difficulty of achieving real tax reform: "We had proposed to Congress substantial improvements in the income-tax laws that would have reduced taxes further and eliminated some of the gross inequities, but throughout my term it was all we could do to hold our own and prevent the tax relief avalanche that was always ready to descend and wipe out, with even more loopholes, any chance for responsible budgeting.

"In the end we considered ourselves fortunate that a massive tax giveaway program was not passed over my veto. As soon as I left office, the special interests were successful in implementing proposals far worse than those which had been considered by Congress while I was President."[4]

The first major tax revision of Carter's successor, President Ronald Reagan, was the 1981 "Economic Recovery Tax Act," falsely described as "reductions across the board." Although rates were cut 5% in 1981, then 10% in 1982, and another 10% in 1983, upper bracket taxpayers got special benefits immediately.

The maximum rate for unearned income (such as rents and interest) was reduced from 70% to the same 50% maximum that had applied to earned income since 1972, the top rate on capital gains was effectively cut to 20%, estate tax was greatly eased, and corporations got benefits that cut in half their share of federal tax revenues.[5] Meanwhile, the reduction of income tax rates for individuals was wiped out for most workers by FICA tax increases, and they were further burdened by state and local tax increases to make up for cuts in federal grants and services. A January 1985 poll showed 75% agreeing that the "present tax system benefits the rich and is unfair to the ordinary working man or woman."[6]

The changes in corporate income tax rules were known to few beyond those directly affected. Alan Blinder commented: "Because of the complexities of depreciation allowances,

investment tax credits, and a zillion other features of the tax code,...investment decisions are tilted toward lightly taxed activities and away from heavily taxed ones. But when tax preferences get so extreme that beating the tax collector becomes more important than beating your competitors, economic efficiency is in deep water. The business tax cuts of 1981 did not create this problem, they just made it worse [and] drastically increased the degree to which investments in equipment were favored over investment in structures....

"Had the 1981 law remained in effect, the efficiency losses from tax distortions would have become monumental—and all in the name of unleashing private enterprise! Fortunately...the most grotesque provisions of the 1981 law were repealed in 1982...."[7] However, the tax "reformers" were at it again in 1986.

If you experienced the avalanche of praise from the media and politicians of both parties that accompanied the enactment the "U.S. Tax Reform Act of 1986," you may find it hard to believe that this law, enacted by a bipartisan coalition in Congress and applauded by corporate lobbyists, was hideously flawed. If you recognize its deceptive nature, you may wonder how a bill that promised reform and simplification came to be such a monstrosity.

It started in November 1984 with a Treasury Department proposal entitled *Tax Reform for Fairness, Simplicity, and Economic Growth*, described by Blinder as logically coherent, bold, equitable, efficient, and simpler. He said that, with few exceptions, it "championed the national interest by stepping hard on the privileged toes of the vested interests." The revised version, *Treasury II*, issued six months later with presidential approval, had most of its best features deleted, and then Congress added its typical touches. After another six months a 1,400-page bill emerged from the House Ways and Means Committee. In its turn, the Senate Finance Committee took care of its favorite interests.[8]

Falsely depicted as tax simplification, the law cut the top rate of individual income tax to 28%, applying it to single taxpayers earning over $17,850 the same as billionaires, and *raised* the tax rate from 11% to 15% for nearly two million

taxpayers earning less than $10,000 a year. Quoting government handouts, the media mentioned only two brackets, 15% and 28%, although the highest marginal rate was actually 33%. Rather than create an explicit 33% bracket for all to see, Congress inserted complex provisions only experts could follow, including a 5% surcharge that applied, in the case of to a family of four, for example, until taxable income reached $194,050. Above that level the marginal tax rate reverted to 28%. Blinder commented in his 1987 book: "In a departure from a tradition as old as the income tax itself, the highest marginal rate no longer applies to the highest incomes."[9]

Reporter Henning Gutmann in *The New York Review of Books* (Feb. 12, 1987) declared the 1986 law "a gift to the rich unmatched since Calvin Coolidge," pointing out that "a science researcher making $22,000 a year pays the same 28% marginal tax rate as Lee Iacocca, who makes over $1,000,000 a year." Tax lawyers, according to Gutmann, agreed that the new bill was anything but a simplification.[10]

Apart from bracket changes, middle class and poorer working taxpayers lost many other benefits. Various forms of "employee business expense" were curtailed or disallowed. Deductions were abolished for state and local sales taxes and for interest, except on mortgages, where a taxpayer could deduct all the interest on as much as two $500,000 homes (opening a market for tax-deductible "home equity" loans). The two-earner marital deduction was abolished, resulting in what was denounced a decade later as the "marriage penalty," and the popular Individual Retirement Account (IRA) was all but eliminated.

The bill also repealed deductions or favorable treatment for unemployment compensation, child adoption expenses, most prizes and awards, scholarships, fellowships, educational travel, and farmers' land clearing expenses. Income averaging, which had helped people like athletes, entertainers, and others whose period of stardom can be brief and whose incomes can fluctuate wildly from year to year, was repealed. Senator Levin (D.-Mich.) pried the information from the Treasury that 359,000 taxpayers earning over $200,000 were going to get an average tax cut of

$52,535, while the bill would raise taxes for 25 million taxpayers and leave the taxes of 33 million unchanged.

A bonanza for business

Meanwhile, corporations "made out like bandits." Some business excesses were trimmed, such as business meals and entertainment deductions, although plenty of other corporate executive perks remained tax free, and the maximum corporate income tax rate was reduced from 46% to 34%, while oil and gas tax shelters were not touched. "Transitional" rules created 174 special exceptions for corporations including Unocal, Phillips Petroleum, Texaco, Pennzoil, General Motors, Chrysler, Goldman Sachs, Manville, General Mills, Walt Disney, Pan Am, Northwest Airlines, Delta, Control Data, Multimedia, Metromedia, Mitsubishi and Toyota.[11]

The benefits to business were bipartisan. The Republican Senate Finance Committee Chairman Packwood and Democratic House Ways and Means Committee Chairman Rostenkowski worked smoothly together for the business interests who contributed heavily to both parties. Chairman Packwood formed a coalition of 31 senators who agreed before the bill was introduced to oppose any amendment of it. The "transitional rules" were the way he paid for support. Chairman Rostenkowski received requests on 3"x5" cards from the 36 heavily lobbied members of his committee. After a private meeting of the two chairmen, Rostenkowski came out with a stack of the cards and passed them out to the winners.[12]

Cathie Martin's 1991 book describes how Packwood engaged in "a final orgy of vote buying" for up to $100 million each in tax expenditures. "Symms (R.-ID) was given an amendment to exclude mining exploration and development costs from minimum tax base. Heinz (R.-PA) and Durenberger (R.MN) won a shorter depreciation period for residential rental real estate....Six major steel companies got a transition rule worth about $500 million....Cabbage Patch magnate, Xavier Roberts, received a tax break designed exclusively for a "taxpayer who incorporated on Sept. 7, 1978, which is engaged in the business of manufacturing dolls and accessories."[13]

Despite all this log-rolling, most of the information media, amazingly, praised the law for fairness and simplification, but 1987-89 public opinion polls declared it less fair and more complicated than the previous law (which had already been judged unfair by 75% of respondents in 1985).[14]

Simplification that complicates

Politicians use the word "simplification" as casually as they do "reform" and journalists often fail to do a reality check, although taxpayers find they have been bamboozled when they get their bills from H. & R. Block. There was a time when laws were titled "The Revenue Act of 19xx," but, as Orwellian spin grew to become the political norm, titles began to incorporate an advertising message: "The Economic Recovery Tax Act of 1981," "The Tax Equity and Fiscal Responsibility Act of 1982," and "The Tax Reform Act of 1986," for example. The chief claim made for the 1986 law was simplification.

By 1992, Quirk and Bridwell, in *Abandoned: The Betrayal of the American Middle Class Since World War II*, noted: "The Reagan administration tripled...the number of pages in the Internal Revenue Code....Revenue raising still takes about 15 pages of the code; the remaining 4,000 pages are devoted to influencing personal and economic behavior, and to special-interest handouts."[15] In June 1991 the IRS reported that tax compliance by small business dropped sharply in the 1980s, and IRS Commissioner Fred Goldberg told Congress most of the noncompliance was unintentional due to the complexity of the tax laws.

Further confusion was introduced in the 1997 tax law, praised by President Clinton and Congressional leaders as part of their compromise "balanced budget" agreement, and also heralded by most of the communications media. Continuing the practice of sloganizing titles, it was labelled "The Taxpayer Relief Act of 1997." Tax simplification got another setback as some tax changes had different effective dates and varied from year to year for ten years.

"If anything, the language in this is more arcane than anything I have ever seen," declared Doug Walters, H&R Block's

head of education. The 100 largest firms in tax preparation were estimated to have received $5.2 billion in revenues in 1995. The worksheet for capital gains taxes was nearly doubled in size with about three dozen new lines, according to Sheldon Schwartz, who oversees IRS tax forms and publications. The 1997 law is the 54th major public law change to the tax code since 1986, according to another IRS official, Stuart DeWitt.[16] The following year a further change was made affecting capital gains on assets sold after January 1, 1998.

Claims of simplification often hide efforts to insert special favors in the tax law, as was true in the case of the 1986 law and also the "flat tax" proposals that keep cropping up. Since wealthy individuals and corporations are the major contributors to political campaigns, they have reaped the benefits of most changes in the tax law since World War II. The top income tax rate on incomes over $200,000 remained 91% from 1941 to 1964, but was reduced to 70% in 1964, 50% in 1981, 28% in 1986, and only slightly increased to 31 35% in 1991.[17]

The special favors to business in the 1986 tax law had a counterpart in 1990 after George Bush became president. Special interests put together a new set of transitional rules and specific giveaways including (1) developers of low income housing; (2) oil and gas producers (Senators Dole and Bentsen); (3) all property and casualty insurance companies; (4) selected wineries (Senator Packwood); and (5) charitable deduction for full market value of painting given to museum (Senator Moynihan). The Joint Committee on Taxation reported, on Oct. 26, that the 1990 Budget Deal revenue-losing provisions would cost taxpayers $27.4 billion over the next 5 years.[18]

10. IS THE TAX BURDEN SHARED FAIRLY?

Besides the fallacious claims already discussed (that the upper-bracket tax reductions stimulated economic growth and that they increased government revenue by the "Laffer effect"), another claim was that the well-to-do were taking on more of the tax burden. This amazing conclusion was propounded with statistics that don't bear close examination. Some proponents of this idea traced changes in the share of income taxes paid by those in tax brackets above a specified dollar amount, while ignoring the variation in purchasing power of those dollars (nominal vs. real dollars). For example, $200,000 would buy $200,000 worth in 1980, but only about $169,000 worth in 1988 and $153,000 worth in 1990 (as measured in the purchasing power of 1980 dollars), thus expanding the bracket downward to include incomes of less purchasing power (a phenomenon known as "bracket creep").

This shows how misleading statistics can be when statements that appear to be literally true fail to reflect reality. Of course, more of the federal income tax revenues come from the rich and near-rich than from other taxpayers (ignoring all other taxes at federal, state, and local levels), but the share paid by them did not grow during the 1980s, as is clear from the previous discussion of tax law changes. Even if their share had grown, that could simply be due to the larger share of national income concentrated in their hands, and a small price to pay for their improved after-tax income.

What is a fair share?

Over time the federal income tax has reached lower and lower income brackets. From its inception in 1916, when relatively few were liable for tax, it was extended to almost everyone at the time of World War II. This was made practical by introducing the practice of withholding taxes from wages.

The idea behind the personal exemption, according to Quirk and Bridwell, was that a "family of four making the median income is not able to, and should not pay, any income tax." As

Steve Schlosstein in *End of the American Century* (1989), pointed out, in 1948 the median income for a family of four was $3,468. Because of the personal exemption and standard deduction, only $801—or 23% of income—was subject to any tax. In 1990 such a family had an income of $29,184 of which $20,421—or 70%—was subject to tax. Federal income tax and FICA amounted to 6% of the income of that typical family in 1948, but 19% for its counterpart in 1990.[19]

For 1990, as computed by the Tax Foundation from IRS data, of the adjusted gross income reported by all taxpayers, the top 5% of taxpayers paid 43% of the taxes; the top 10% paid 54%; the top 50% paid 94%. The bottom 50%, on the other hand, paid only 6% of the taxes, as shown below (note that the "share of income tax" refers not to their tax rates but to their percentage of the total federal individual income tax paid by all brackets).

TABLE 6
DISTRIBUTION OF INCOME
AND OF FEDERAL INCOME TAX

Brackets	Share of income	Share of income tax
Top 5%	28%	43%
Top 10%	39%	54%
Top 50%	86%	94%
Bottom 50%	14%	6%

It could be argued that when 5% of the people pay 43% of the taxes they have paid at least their fair share. On the other hand, the bottom half of taxpayers each earned less than $19,616 and were lucky to cover necessities after the tax bite. For upper-bracket taxpayers the tax merely put a dent in their luxuries and, because of loopholes, they typically received money and valuable perks that are not counted in adjusted gross income.

Those who consider the wealthy overtaxed cite the rates of federal individual income tax as if it were the only tax Americans pay. In 1995 that tax produced $476 billion or only 21% of the $2,262 billion combined federal, state, and local revenues (it had been 26% in 1980 and 23% in 1990). The other

79% was collected by taxes (and revenue sources not labeled as taxes) that are mostly regressive (that is, they impose the greatest burden on the poor).[20]

Compilations for 1990 showed that combined state and local taxes took 14.8% of the annual income of the poor, about 10% of that of the middle classes and a much lower 7.6% from the top 1%, according to Kevin Phillips (1993).[21] The financial transactions of high-income individuals and businesses are much harder to trace than those of lower-income and middle-income taxpayers, whose wages, receipts and transactions can be easily monitored. Small fry are not likely to put much over on the IRS.

Between 1977 and 1990, the tax bill for a taxpayer earning $50,000 a year increased 7.75%, while the bill for taxpayers with incomes of $200,000 a year had dropped 27.5%, according to a university research project commissioned by Thomas Block, president of H&R Block.

The Tax Foundation determined that for the year 1990, direct and indirect federal, state and local taxes cost the typical U.S. family a record 37.3 cents of every dollar, while the average wealthy family with a million-dollar income paid a *lower* rate, probably 35 or 36 cents on every dollar—and probably the lowest in sixty years.

According to Kevin Phillips the effective federal tax rate (income & FICA) for the median family rose from 11.55% in 1965 to 24.37% in 1989, but for the millionaire (top 1%) family it dropped from 66.9% to 26.7% in 1989.

Do high rates kill incentive?

Countering the progressive argument for heavier taxes on those who are best able to afford them, it is often claimed that high rates in the upper brackets kill incentive. This was the thinking behind the 1980s reductions of tax on higher incomes. When newly-elected President Clinton proposed to restore some progressivity, opponents claimed that it would stifle enterprise of those affected—that a 36% or 46% marginal rate would cause high earners to slack off.

Let's apply a little simple arithmetic and logic to this contention. A normal work year consists of nearly 2,000 hours,

which implies that the person with over $250,000 income proposed for the 46% rate is receiving over $125 per hour of taxable income. Although such people are not usually paid by the hour, lawyers, accountants, and other professionals often value their services at hourly rates.

A discussion of marginal rates has to do with increments, which in this case could reasonably be viewed as the next hour's effort after $250,000 income has been reached. The effect to be considered is whether taxing 46% of the $125.00 or more income from that hour, leaving at least $67.50 after tax (not counting additional income in tax shelters), would cause such a high income person to withhold further effort.

The answer would depend on the marginal utility of that net income (plus any psychic income) versus the marginal utility of an hour's leisure or other preferred activity. Economists have numerous theories and a few measurements of marginal utility, but little measurement of psychic income, such as professional accomplishment. At high income levels, money is no longer the primary motivation, because professional devotion, prestige, and power become more important. While we shouldn't "soak" the rich, it's only right for them to bear a fair share of the burden, as more than a few of them have stated their willingness to do.

When Clinton's proposed increases were somewhat whittled down to a maximum marginal rate of 39.6% and enacted in 1993, Republicans began referring to it as the "biggest tax increase in history." That is untrue in terms of inflation-adjusted dollars. The revision actually reduced taxes on the working poor and only increased income taxes to the extent of partly restoring the upper-bracket cuts of the 1980s. To the chagrin of the Republicans, who had predicted these tax changes would bring economic disaster, economic indicators remained favorable and Clinton was reelected in 1996.

Economist Robert Eisner derided the claims of supply-siders that the marginal effective tax rate is so high it discourages work at the high end of the income scale. He asked what to expect from corporate executives faced with increases in their marginal tax rate from 31% to 36% or even 39.6%. "I doubt many will decide not to work as hard and risk getting off the corporate

success ladder." In fact, he said, the high marginal rates are overwhelming at the lower end of the income scale, for those on welfare, and for middle-income taxpayers on social security, where loss of benefits and tax increases can be more than the additional income from working.[22]

Savings and Investment

A questionable bit of conventional wisdom is that growth depends on people saving more. The idea is that the limit on economic growth is determined by savings available for investment, which, of course, does set a limit on the supply side, but is not the only determinant. More often, I suspect (especially in depressions or recessions), the effective limit to economic growth is not so much on the supply side as on the demand side (if customers don't have the money to buy it, why would producers supply it?). On the other hand, if the growth of the American economy is effectively limited at times by savings available for investment, then it is right to consider the savings pattern of Americans.

The financial community sporadically complains that Americans save less of their incomes, on the average, than people in other industrialized countries, Germany and Japan being often cited. In such countries capital is traditionally supplied by loans from banks to a greater extent than in the United States, and those loans make use of funds deposited with the banks as savings. International comparisons seldom mention that U.S. firms depend much more on corporate savings, in the form of retained earnings, to finance their projects. Many stockholders in U.S. corporations prefer earnings to be retained, as they would rather see their stock appreciate in value than to receive dividends on which they would have to pay tax. Furthermore, in a globalized financial economy, U.S. corporations need not borrow exclusively against savings of Americans as they have the capital markets of the world at their disposal.

Saving is a luxury that only a wealthy minority can enjoy to any important extent. Many low-income families actually have negative savings—that is, using up savings from the past or going into debt. The top 10% income bracket accounts for most of the

personal saving.[23] The active promotion of credit cards and home equity loans by banks and other issuers has built up an unprecedented amount of household debt, an important form of negative savings. Credit cards alone involved borrowing of more than $1 trillion in 1996, 40% of which was "revolving" and piling up finance charges, according to the Consumer Federation of America. Ruth Susswein, executive director of Bankcard Holders of America, said more than 2 billion card solicitations were being mailed each year, with 58% of households with incomes under $20,000 receiving credit offers.

One of the arguments in the 1980s for easing tax rates on the upper brackets was that they would save and invest money they would otherwise have paid the federal government in taxes, thus financing an increase in production and in jobs. In fact, Treasury Secretary Donald Regan helped sell the big tax cuts to Congress in 1981 by arguing that about 40% of the personal tax reductions would be saved.

Not only did the beneficiaries of tax cuts seem to prefer financial manipulation over business expansion, but the population as a whole registered an unexpected decrease in savings. Net savings of Americans amounted to about 7% or 8% of disposable income in most years from the 1950s through the 1970s, but declined sharply from 1981 to 1987 and averaged just 5.4% of disposable income for the decade of the 1980s.

Eisner's 1994 book, having established that national savings are equal to investment, except for external capital flows, referred to the $530 billion of federal, state, and local government capital expenditures previously cited in connection with deficits and debt. When added to private investment, he calculated it raised the total of gross investment by more than 71%. He added: "This account still excludes household investment and intangible business investment, however. I have estimated elsewhere that net private domestic investment of the official accounts is no more than 21% of appropriately defined, fully comprehensive net capital accumulation in the U.S. economy."

What really counts, according to Eisner, is not "the amount of private saving as currently measured." What is critical, to use his examples, is the extent to which households are

spending to buy durable goods, new houses and children's education versus gambling in Las Vegas; businesses are spending on research for better products and processes versus leveraged buyouts; and government is spending on investment in people and technology at home versus stationing troops in Europe.[24]

Whenever it is important to encourage saving, the method tried in the 1980s is not the right way to go. Economic growth did not improve, and if the savings of the wealthy did increase at all, they were offset by negative savings of the less fortunate.

11. THE STRANGE HISTORY OF CAPITAL GAINS

I don't see any truth to the claim that taxing capital gains stifles growth. Politicians, economists, and editors who worry about taxes killing incentive argue for reducing the tax on capital gains. Supposedly the prospect of making a huge, lightly taxed profit will encourage captains of industry to launch new enterprises that will add to the nation's economic growth. The sales pitch also promises that many new jobs will be created in the process. None of this, however, is supported by any credible evidence.

Ordinary taxpayers have little to do with capital gains, and most find the subject very puzzling. Some found, years ago, they had to pay tax upon selling a home that had gone up in price, but tax relief eliminating that problem in almost all cases has been on the books for many decades. Capital gains from stock trades are mostly a concern of upper-bracket taxpayers, although others may be affected to some extent through mutual funds and pension plans.

As Republicans in Congress during the 1990s proposed to reduce the federal income tax on capital gains, Democrats said the benefit would go mostly to wealthy individuals and corporations, at the expense of programs for the elderly and the poor. Republicans, on the other hand, presented it as a boost to the economy and provider of jobs.

The mystery of capital gains and losses

Historically, little attention has been paid to the difference between a real profit and an increase in price that is due only to inflation. Taxes on ordinary income take no account of inflation because receipts and expenditures are all in the same year. In the case of businesses, of course, inflation can have an effect on the valuation of inventories.

Long-term capital gains (when the asset was owned for a holding period of, say, six months or a year) have been treated

differently from ordinary income, being justified either to offset inflation or to provide an inducement to invest. When an asset is sold, there is a capital gain if it brings more than it cost, and a capital loss if it is sold for less than it cost (allowing for improvements, expenses of sale, etc.). How should these gains or losses affect one's taxes?

Politics aside, there are questions of fairness. What if the supposed gain is fictitious because the higher selling price merely reflects inflation? Then the seller has gained no purchasing power from holding the asset and should pay no tax. This was especially clear to many people when required to pay tax on selling their homes.

As so often happens, Congress dealt with this in response to political pressure rather than logic. Instead of providing an inflation adjustment, they enacted complex rules that enabled one to escape tax on the gain by always trading up to a higher-priced home—a solution approved by the real estate lobby. For many years this largely removed the problem for homeowners, until the 1997 law provided a more general exemption.

A Republican plan was offered to address the problem for other assets by phasing in an adjustment for inflation, and it hard to see why anyone should object to this. On the other hand, if there is a real gain after adjustment for inflation, such income should be taxed at the same rate as "ordinary income," which includes interest, dividends, salaries, and workers wages, as well as profits of unincorporated businesses. Fairness would seem to require the same tax rates for all kinds of income.

As for the neglected issue of capital losses, it seems fair that when they exceed gains the difference should be deductible from other taxable income, and there is no logical reason to limit the deduction. There apparently was a revenue reason, however, and for some 60 years there has been a limit (currently $3,000) that can be deducted in one year, with provisions to apply any excess to certain past and/or future years.

Tax changes over the years

The first tax on capital gains, enacted in 1921, was effectively 40% of the tax on ordinary income. Capital loss limitations were started in the 1930s. In the 1950s and 1960s capital gains on assets held for more than six months were taxed at 50% of the tax on ordinary income. Capital loss deductions were limited to $1,000 in any tax year.

These tax provisions remained remarkably stable for decades until the turmoil following the Arab oil embargo and OPEC price shocks. Conservatives would have preferred the former British practice of no tax at all on gains, while liberals would have preferred the tax on earned and unearned income to be the same. Other inequities existed that were hardly ever discussed.

Beginning in 1970, only 50% of long-term losses were deductible. The 1976 Tax Reform Act closed a loophole that allowed appreciated assets to be passed to heirs without taxing the gain (but this was repealed in 1980). The Revenue Act of 1978 (Steiger Amendment) reduced the effective top rate from 49% to 28% on long-term capital gains. Beginning in 1978, long-term capital gains were taxed at only 40% of ordinary income (losses still deductible at 50%), and the annual limit on losses was increased to $3,000. The Economic Recovery Tax Act of 1981 further reduced the long-term maximum rate to 20%.

The Tax Reform Act of 1986 removed the favorable treatment of long-term capital gains, treating all capital gains as ordinary income. An exception was made in the Revenue Reconciliation Act of 1993, that excludes 50% of gain on small business stock issued after August 10, 1993.

I was astonished when the bi-partisan 1986 tax bill provided for full taxation of capital gains, a proposal that had failed even during liberal administrations. The capital gains change must have been a political trade-off for taking away some of the favorite deductions of the middle class, such as interest paid, state taxes, and various employee expenses. As Republicans agitated to repeal the capital gains change, they made no offer to restore the deductions taken away from the middle class.

Although, generally speaking, the distinction between long and short-term gains became meaningless, Form 1040 still required them to be reported separately. The holding period was one year, except that for assets acquired after June 22, 1984, and before 1988 it was six months.

In 1997 the law was amended to require a holding period of 18 months, while reducing the maximum rate to 20%, with complicated transition rules and lengthy computations required in tax returns (another demonstration that Congress tends to complicate rather than simplify the tax code). The holding period went back from 18 months to one year effective for sales of assets after January 1, 1998, keeping the 20% reduced rate, in a provision included in the IRS overhaul bill passed in July 1998.[25] In all of these changes, the equitable proposal to use inflation adjustment in calculating capital gains was lost and apparently forgotten.

How the rules favor the prosperous

Capital gains have always offered advantages to the wealthy that applied even under the 1986 law when the rate was the same as for ordinary income: they continued to be able to avoid paying tax on appreciated assets either by donating them to a charity (with the contribution counted at the higher value) or leaving them to their heirs. (The latter loophole having been closed in 1976 but reopened in 1980.) These advantages were not affected by the 1997 law.

There has also been a less obvious advantage for the wealthy whenever capital gains are taxed less than earned income. You can benefit from the lower rate on capital gains only if you gain more than you lose because losses have to be offset against gains, but small investors typically are lucky to break even. Thus the tax law favors the winners over the losers in the stock market, and, by definition, the wealthy are the winners in the economic contests of life.

Conservatives would, of course, prefer to pay little or no tax on capital gains but find it hard to counter the liberals' argument that income from inherited wealth should bear the same tax burden as income earned by mental and/or physical work. The

argument they fall back on is that the tax savings from lower capital gains rates will be used for further investment that will be good for the economy, as proclaimed in the "Job Creation and Wage Enhancement Act" of the 1994 Republican "Contract with America."

Unfortunately for that theory, the record shows that most of those who profited from tax cuts in the 1980s didn't invest in building U.S. industry. Instead, they invested abroad, engaged in financial speculation, or bought U.S. government bonds. A better way to stimulate investment and job creation would be to encourage small independent businesses, who have been shown to be much more effective for new products and new jobs than the corporate giants. That could be done by appropriate tax incentives and by enforcing the anti-monopoly laws to protect small business from unfair competition.

12. SHOULD CORPORATE INCOME TAX BE ABOLISHED?

It has been argued that taxing corporations just adds to consumer prices. Whenever a company has to bear a burden, whether pollution control expenses costs of meeting health and safety standards, or taxes, it is likely to take it as an excuse to raise prices. Experience tells us that when burdens are removed, companies do not always reduce prices. In regard to the corporate income tax, economists disagree on the extent to which the burden ends up with the corporation's shareholders or is shifted to consumers. This question comes under the heading of "tax incidence."

A monopolist, having already selected the quantity of production and price to return maximum profit, cannot gain from raising prices in reaction to a tax that takes a percentage of his profits. In the case of a monopoly corporation the stockholders are stuck with the corporate income tax. Other degrees of competition make the result harder to determine. Economists must consider such complications as elasticities of supply and demand (that is, how responsive supply and demand are to price changes). The burden may fall partly on shareholders and partly on consumers.

The inequity of double taxation

One argument against corporate income tax is that stockholders are taxed twice. When the profits that have already been taxed at the corporate level are distributed as dividends, the stockholder is taxed again. This objection is quite valid, but political solutions, as usual, attack the problem in the wrong ways. For many years prior to the 1986 tax revision, taxpayers were allowed to exclude some dividends from their taxable income. Also, over the years, there has been considerable reduction of the corporate income tax, partly by rate reductions and partly by rules changes.

In fifty years the share corporations pay of all federal taxes dropped from 35% to only 11%, according to the *Economic Report of the President*, Feb. 1995.[26] Looking at just federal

income taxes, Treasury Department figures for fiscal 1995 show that corporations paid only 21% and individuals 79%.[27]

In 1991, according to the General Accounting Office (GAO), 37.2% of large U.S.-controlled multinational corporations having assets greater than $100 million did not pay a single dollar in federal taxes. An additional 30.2% of these companies paid less than $1 million. The most common way for them to avoid tax is to claim that costs of their foreign subsidiaries are U.S.-related, thus reducing their reported U.S. profits.

Another example: in 1983 the chemical industry had an effective tax rate of *minus* 1% giving them a credit for future tax years. according to the House-Senate Joint Tax Committee, which also reported a mere 0.7% tax paid by the construction industry on its earnings. As of 1985, General Electric had not paid a dollar in federal corporate income tax for three years, despite earnings of $5 billion during that period.[28]

But then, what about the unfairness of double taxation? Should corporations pay any income tax at all? Wouldn't it be fairer just to collect tax from stockholders as the income is distributed to them in the form of dividends? There are at least two problems:

1. Corporate earnings are routinely reinvested in the business, especially in closely-held corporations, and these retained earnings are reflected in the stock price. The stockholder, who would not have been taxed for dividends from those earnings, can also avoid tax on the capital gain by such maneuvers as donating the stock to a charity and deducting its full market value, or simply leaving it to his heirs, who also escape tax on the gain according to current rules.

2. Partly or wholly foreign-owned corporations could operate in the United States without either the corporation or its foreign stockholders paying tax, unless the government could enforce a claim against dividends paid to the foreign stockholders.

Decades ago when the dividend exclusion was introduced, a better solution had been proposed, but Congress has still not listened. The fairest treatment would seem to be to collect corporate income tax as a withholding tax, just as employers withhold tax from workers' wages. Each stockholder's share would then be a credit against the individual tax at his bracket on

his dividends, just as employees take credit for tax withheld against tax due. This, together with proper reform of the taxing of capital gains, would be fairer than any rules we have had so far.

Another remedy was proposed by David Korten in a 1996 interview: “I favor an elimination of corporate income taxes in conjunction with the requirement that corporations pay out their profits each year to shareholders, who would pay taxes on the dividends at their established marginal rate. These corporations would then have no incentive to shift profits around the world to the jurisdiction with the lowest tax rate....”[29]

13. CAN YOU TAKE TAX SHELTERS WITH YOU?

Advocates of abolishing the inheritance tax greatly exaggerate the problem when they blame it for wiping out family fortunes and destroying family businesses. There are many sad accounts of heirs inheriting little or nothing from parents who had considerable wealth. In fact, this has happened often enough to be a matter of concern, although it is not the general rule. The worst examples usually involve lawyers who have looted the estate either by direct theft or by exorbitant charges allowed by friendly probate court judges. In some cases the bulk of the estate has been used up in litigation by parties attempting to break the will.

Many other instances have been recorded of trustees, such as banks, who failed to act in the best interests of the heirs, keeping trust funds in bank accounts that paid little interest, or churning investments until they were eaten up by transaction costs, all the while charging large fees for managing the trust. In other cases, a going business became worthless because of problems of management due to the death of the owner.

It is also true, when considerable wealth is left to the heirs, that the assets may be reduced by federal estate tax and/or state inheritance tax, and if liquid assets are insufficient some property may need to be sold to cover taxes. Unless the estate has been depleted by unreasonable probate fees, litigation by heirs, mishandling by fiduciaries, or problems of transferring business ownership, however, the heirs generally end up with most of the value left by the deceased.

Whether children of privilege should have an advantage over other children, and if so to what extent, is a philosophical and ethical question. President Franklin D. Roosevelt said in a 1935 message to Congress, “Our revenue laws have operated in many ways to the unfair advantage of the few, and they have done little to prevent an unjust concentration of wealth and economic power.”[30] Congress then passed the Revenue Act of 1935 (Wealth Tax Act) that affected estates of more than $40,000 (a

large amount then), and also included income tax increases for high-bracket individuals and large corporations.

The importance of inheritances is not trivial in the national economy. In 1973, 56% of the total wealth of persons 35-39 years old was given to them by their parents and by 1986 the figure had risen to 86%, with higher ratios still to come.[31] Exemptions have kept the federal estate tax from affecting modest fortunes, and estate planners have been quite effective in setting up schemes for large estates to avoid much of the tax by such means as gifts, life insurance, and trusts. This is a far cry from the death duties in England so deplored by the landed aristocracy, some of whom have married American heiresses desirous of titles and others have deeded their ancestral homes to the National Trust or opened them to visitors for a fee.

Many loopholes have been provided in U.S. tax laws. For example, to prevent family farmers from having to sell their land to pay taxes, the value of farm land may be computed for estate tax purposes by a formula that, on the average, cuts the value by half. Heirs may postpone payment up to five years and then pay in ten installments at only 4% interest. Until 1980 farmers had to pay tax, when selling the land, on the gain over the purchase price, but Congress then changed it so they need only pay taxes on any increase in value since the land was inherited.[32]

In 1981 Congress created a flat $600,000 exemption (effective in 1985) to the estate tax, further limiting its application so that it is now imposed only on the largest inheritances, slightly more than 1%.[33] Only 31,500 of the 2,300,000 Americans who died in 1995 owed any estate taxes, according to the Joint Committee on Taxation, and only 4% of farmers leave taxable estates, according to the IRS.[34]

For those fortunate people with large estates there are significant escape hatches. How one of them works was described by a wealthy attorney in a fund-raising letter to alumni of his college. By donating stock worth about 40 times what he paid for it he escaped thousands of dollars of capital gains tax, took an income tax deduction in the thousands of dollars, avoided estate tax on the value of the stock, and received an annuity from the

college paying twice what the stock was yielding. His wife got a similar deal from her college. He declared it works like magic!

The private foundation provides another way of avoiding estate tax. In an interview published in the December 1995 *Multinational Monitor*, Sol Price, of the "Forbes 400" list of the wealthiest individuals in the United States, explained: "Warren Buffett [plans] to sink his whole fortune into his own private foundation...which works on population control. Many people think this is a worthwhile thing. But of this whole $12 billion that he has accumulated in his lifetime, none will ever by taxed....

"There is a guy named Arthur S. DeMoss who died a few years ago and left maybe $300 million or $500 million to a private foundation that opposes abortion. So the government collects no estate tax from this. And the perks the family has when they set up these private foundations are almost the same as though they retained the money directly. Our law has allowed people to take what should go to the government and use it for their own purposes, some of which we may agree with and others that we may not...."

In addition to the federal estate tax there is a gift tax intended to prevent a donor from circumventing the estate tax by making large untaxed gifts to prospective heirs during the donor's lifetime. The extent that these taxes (estate and gift) have been reduced or avoided is shown by the fact that they accounted for more than 5% of all federal receipts in 1940, but dropped to 1.7% in 1950 and 1.1% in 1990.[35]

14. THE FLAT TAX AS THE ULTIMATE SIMPLIFICATION

I don't know how many people believe it possible to have a flat tax that would really be flat—and fair—although politicians keep on proposing it. Wouldn't it be great to deep-six the whole tax code and regulations, put the tax lawyers and accountants out of work, and report your income on a postcard-size form? You wouldn't even have to pay any income tax on the first $20,000 or so, and then everyone would pay a flat 19% according to one version. Some proponents have claimed it would eliminate "loopholes, dodges and any chance to cheat" and that "liberals who see a flat tax as regressive are wrong."

If you think this sounds too good to be true, you are right, for the following reasons:

1. Politicians will never enact this scheme, whatever their party, because they are all under obligation because of campaign contributions and other favors to protect the loopholes of their benefactors. They might pass something with the title of "flat tax," but it would be as phony as the "tax reform" of 1986.

2. Even if the flat tax could be enacted, total income without deductions or write-offs is not a simple concept. Most of the over five million words in the tax code have nothing to do with people who live on wages and salaries. They have to do with how business and investment income are calculated. Take an example:

Suppose you own a store. If you collect $1,000,000 from your customers, that is not your income. Perhaps you had to pay 80% of that to your suppliers for the merchandise, so you keep $200,000. But you also have to pay rent, insurance, local taxes, wages to employees, etc., so you could be very lucky to have $100,000 left. Paying 19% of the million dollars ($190,000) would put you into bankruptcy! The place that loopholes are created—not usually by accident, but by lobbying power—is in the rules for what is to be included or deducted in figuring taxable net income.

3. It gets even more complicated for the corporate income tax, which brings up the valid argument already discussed against

double taxation (of corporate income and of stockholders' dividends). Income is not simple and obvious.

4. That $20,000 exemption for everyone would lose purchasing power over time unless increased to offset inflation.

5. While a flat tax, if a fair one could be enacted, would be roughly proportional rather than regressive, the sum of all taxes (federal, state and local of all kinds) bears most heavily on people of ordinary means and is therefore regressive. When the federal income tax is somewhat progressive, as intended, it helps to balance the regressive nature of other taxes.

6. Some of the same politicians who favor a flat income tax also have been recommending a value added tax (VAT) along the lines of the ones in Europe that add 15% or more to the price of most items. This is in the nature of a national sales tax—a regressive tax—and is in addition to the income tax.

Tax deduction for contributions

Getting rid of unwarranted exemptions and deductions would, of course, be desirable. One simplification that would help to clean up politics would be to abolish income tax deductions for charitable contributions. This suggestion will certainly make some people fighting mad, but remember that many tax-exempt contributions are far from charitable, nor educational, nor religious.

The problem is that the Internal Revenue Service and the courts have difficulty deciding what is or is not a legitimate tax-deductible contribution. Examples include matters currently in litigation such as donations by individuals and corporations to ostensibly non-partisan educational or religious organizations that the Federal Elections Commission claims were used to help political candidates and parties.

Then there are the many "think tanks" which produce some useful research but also release propaganda for the views of the corporations that supply much of their funding. For example, the National Center for Public Policy Research attacks state attorneys general for their efforts to hold tobacco companies responsible for the damage they have done and denounces clean air regulations.

Also, the American Enterprise Institute, the Cato Institute, the Competitive Enterprise Institute, the Heritage Foundation, the Hudson Institute, the Progress and Freedom Foundation, and the Washington Legal Foundation led an attack on the Food and Drug Administration, having received at least $3.5 million in contributions from corporations interested reducing the agency's efforts to protect public health. Some other non-profit organizations attack Social Security and environmental protection laws.

Such are clearly not the charitable, educational, or religious activities for which tax exemption provisions were created. Yet where does one draw the line? Should we have thousands of pages more of laws and regulations to define what is legitimate or not?

Most people would think it is a good thing for the government to encourage charitable contributions by allowing tax deductions, but is it necessary? A possible tax deduction is not the reason, in most cases, that millions of people contribute to their churches, local charities, colleges, youth organizations, etc. According to a study by John S. Barry of the Heritage Foundation, "donors earning less than $20,000 give more...as a percentage of income than those earning between $50,000 and $100,000."

The giving of low-income taxpayers is all the more impressive because there is no tax benefit unless contributions combined with other itemized deductions total more than the standard deduction. This usually means that people with modest incomes can get no benefit unless they have mortgage interest and real estate taxes to itemize.

Tax savings are more likely for families grossing $1 million or more, but a study of their tax returns for 1986 showed that only $7 billion out of a total of $82 billion went to charities.[36] The officers of tax-exempt organizations can be expected to oppose any change in deductions, as they would be reluctant to give up inducements for donations they can offer under the present rules, but legitimate charities really need have little fear.

Tax incentives did not enter into it when some of the greatest contributions were made by the wealthy in the 19th century, such as Andrew Carnegie, who established public

libraries throughout the United States and gave away $350 million in his lifetime (about $7 billion in 1996 purchasing power).[37] In the 20th century the Rockefeller Foundation, the Ford Foundation, and many other charitable enterprises founded by the wealthy supported vast worthwhile efforts, while the alumni of the best colleges endowed scholarships that opened up first class education to young people of modest means. It unfairly diminishes these good works if they appear to have been done for tax avoidance.

If it would solve the problem of separating real charity from scams and propaganda mills, wouldn't it be worthwhile to abolish the income tax deduction and take this small but important step toward tax simplification?

15. THE GROWING GAP BETWEEN RICH AND POOR

When anyone points out the extreme inequality of wealth and income that has been developing in the United States since the late 1970s, the favorite retort is “class warfare!” or “politics of envy!” followed by a sermon on the merits of capitalism versus communism. One may object to the widening gap between rich and poor, however, without going to the opposite extreme.

Many examples suggest that the wealthy are not always happier than other people (although they are spared the discomforts of the poverty-stricken). They appear to be envied because of the fascination of millions with stories of the “life-styles of the rich and famous.” Yet there is an interesting quirk of human nature that contradicts this impression.

Envy is most strongly revealed against people much closer to the same social level who seem to be getting advantages at the expense of the individual concerned. For this reason, a worker may become much more resentful against a penny-ante welfare chiseler than against a savings and loan executive who has stolen millions. Those who speak for the wealthy take advantage of this trait by deflecting resentment away from them and toward the poor.

Donald Kaul of the *Des Moines Register* declared: “We are now engaged in an experiment in government of the corporation, by the corporation and for the corporation. Those of us who oppose that...are hooted down with shouts of class warfare....

“Not content with getting the lion’s share of the hunt, the people on top demand (and get) lower taxes and argue for fewer government benefits for the most needy, lest those unfortunates be corrupted by getting something they don’t deserve.

“The truly odd thing about this is that the people in the middle, who are treading water as fast as they can, have bought into this system. They think the wretched—immigrants, welfare mothers, the homeless—are taking bread from their tables.”[38]

The main reason for avoiding an undue concentration of wealth, income, and power, in my view, is not a matter of loving or hating those on top. History has shown, in more than one country, that prosperity occurs when the people have enough money to buy the goods and services that suppliers want to sell. For this reason businessmen should favor many programs that they often tend to denounce as "liberal" or "left-wing."

Perhaps the most important concern about concentration is the power that goes with wealth, and, as Lord Acton accurately said in 1887, all power tends to corrupt, and absolute power corrupts absolutely. In the many dictatorships of this world, members of the small ruling class live in luxury behind fortified walls that protect them from the general population living in squalor. We are beginning to see that tendency in America, as business tycoons hire bodyguards and make their homes in well-guarded enclaves. Further movement in that direction would weaken democracy. Already the U.S. has a greater disparity in incomes than other industrial nations.[39] This leads to domination of government by those who can afford to buy political favors.

Statistics on income distribution are notoriously unreliable, so the following data should be viewed skeptically, but bear in mind that the gaps are greater than the figures reveal. Some statistics are self-reported to survey interviewers, and the wealthy are traditionally reticent. When the statistics are from tax returns, there are opportunities to cheat (especially for proprietors whose incomes are not subject to wage withholding) and, even more significantly, tax rules exclude some items from taxable income. Wealth is even harder to measure than income as it is not reported regularly on tax returns.

The best survey of American's wealth was conducted in 1963 by Projector and Weiss for the Federal Reserve System, according to *Who Gets What from Government* by Benjamin I. Page (1983), who noted: "Many respondents, especially those of high income, refused to give financial information, so efforts were made to adjust for nonresponses. Projector and Weiss found that distribution of net wealth was...more unequal than the distribution of income. The top 1% of wealth-holding consumer units held

about 33% of the total wealth and 62% of the corporate stock. About one-quarter of the population, on the other hand, had a net worth (including value of cars and equity in homes) of less than $1,000, and nearly half had less than $5,000."[40]

More recent Federal Reserve figures for 1989 showed that the richest 1% of American households, each having net worth of at least $2.3 million, accounted for nearly 40% of the nation's wealth. The top 20%, having $180,000 or more, accounted for 80% of the wealth, a greater degree of concentration than in any other industrial nation.[41]

Turning from wealth to income distribution, according to 1996 data the top 5% of U.S. families received 20.3% of total money income, and distribution by population fifths was: [42]

Top fifth	46.8%
Fourth fifth	23.1%
Middle fifth	15.8%
Second fifth	10.0%
Bottom fifth	4.2%

Another measure of income gaps was calculated in a publication of the Russell Sage Foundation, which found that in 1988 American men in the bottom 10% had earnings equal to just 38% of the median, compared to 68% in Japan and 61% in West Germany, and their earnings were only 45% as much as Germans and half as much as Italians.[43]

Greed in the board room

Some of the most powerful Americans are chief executive officers (CEOs) of major corporations, who usually are also well compensated to serve on the boards of other corporations, as well having private fortunes. According to a study of the 300 top companies by Graef Crystal, who teaches the facetiously nicknamed "Greed 259-A" course for MBAs at the University of California at Berkeley, CEOs earned 145 times more in 1992 than the average worker, up in 1993 to 170 times and in 1994 to 187 times.

"We are creating a wealthy and privileged corporate aristocracy," Crystal declared, "at a time when a lot of people are losing their jobs or seeing their wages decline. If you extrapolate those numbers to the year 2010, the ratio will correspond to the gap that existed in France in 1789 between the aristocracy and everyone else. And we all know what happened to the aristocracy in France."[44]

Another estimate for 1992 put the compensation of the average CEO of a major company at 157 times that of the average worker, compared with a 40 to 1 ratio in 1960. The average pay for the CEOs of the 1,000 largest corporations in 1992 was $3,840,000, up from $625,000 in 1980. This comment appeared in *Business Week*: "At a time when the incomes of 90% of corporate employees are barely growing...these multimillion dollar windfalls are arrogant. They imply that no one else but the CEO is responsible for the good performance of the company."[45]

By 1996 the average CEO pay had risen to $5,800,000. By 1997 *Business Week* estimated the ratio of CEO pay to workers pay was 209 to 1.[46] In 1997 Michael Eisner, CEO of the Walt Disney Company, received more than $575,000,000 compensation in the form of $10,000,000 salary and bonus plus stock options cashed in of $565,000,000.[47] In 1993 the compensation package of $203,100,000 received by Eisner had equaled 68% of the company's $299,800,000 total profits for the year.[48]

Although corporate management claims the huge salaries and bonuses of CEOs are earned, there are many cases that are hard to justify. For example, ITT Chairman Rand Araskog raked in $4,255,000 in 1986, despite a 14.2% corporate sales slump, and Robert Forman of E. F. Hutton got a 23% cash raise in 1986, while company earnings dropped 17%.[49] When Lone Star Industries took a $271 million loss in 1989, its CEO James E. Stewart ordered layoffs, sold off $400 million of corporate assets, cancelled the dividend to stockholders, and cut his managers' expenses, but kept a $2.9 million expense account for himself and commuted in a corporate jet from his Florida home to Connecticut.[50]

By 1997 the rewards of failure at the top had multiplied. *The New York Times* reported in July that John R. Walter failed to measure up to the job of president of AT&T but left after only 8 months with a $26 million goodbye present, Michael Ovitz lasted 14 months as a top executive at Walt Disney Company and got $90 million in severance pay, while Gilbert F. Amelio received a mere $7 million when dropped as head of Apple Computer.[51]

Confusing capitalism with democracy

Some people act as if democracy and capitalism meant the same thing. While celebrating the collapse of Communism in the Soviet Union, the mass media, as well as most politicians, confused the elements of capitalism and democracy that were replacing it and treated democracy and capitalism (or "free markets") as tantamount to synonyms.

Thurow explained the difference this way: "Democracy and capitalism have very different beliefs about the proper distribution of power. One believes in a completely equal distribution of political power...while the other believes that it is the duty of the economically fit to drive the unfit out of business and into economic extinction....To put it in its starkest form, capitalism is perfectly compatible with slavery....Democracy is not compatible with slavery....

"Capitalism generates great inequalities of income and wealth....Driving others out of the market and forcing their incomes to zero...is what competition is all about....Accumulated wealth leads to income-earning opportunities that are not open to those without wealth...."[52]

Soviet Communism, as generally understood in the West, was a term that incorporated two intertwined systems: economically, it was characterized by public ownership of almost all factors of production ostensibly for the benefit of the common people but actually permeated by corruption and special privileges for the powerful; politically, it was an authoritarian regime ruled by a single political party without free speech or free elections—in other words, a dictatorship, a tyranny, the kind of repressive

government that unfortunately exists in many nations that have been officially categorized as anti-Communist. The economic and political systems were tied together but not logically inseparable.

Billionaire George Soros declared in the February 1997 *Atlantic Monthly* that the main enemy is no longer Communism but "the capitalist threat," because the world is relying too heavily on free markets and unregulated capitalism to create prosperity and protect individual freedom under the pure laissez-faire theory that society benefits from everyone's "uninhibited pursuit of self-interest." Abolishing Communism is not enough, he said, if it is replaced by galloping greed that concentrates wealth in ever fewer hands. "If there is no mechanism for redistribution the inequities can become intolerable."[53]

Concentration of wealth hurts the economy

Concentration of wealth leads to the stagnation that characterized the Great Depression of the 1930s and is the lingering condition of oppressed countries throughout the world. The pet economists and politicians of the financial elite proclaim that tax reductions for the upper brackets will encourage them to invest and thus stimulate the economy. The relatively simple but little recognized fact is that producers will keep increasing their output only if they find markets for their products and services.

The cause of a recession or depression is not lack of funds for investment but a shortage of money in the hands of consumers. Among the few voices pointing out that supply cannot grow indefinitely without lower income groups being allowed enough purchasing power to consume the goods and services produced under the control of the financial elite, is that of William Greider.[54]

During recessions unsold goods pile up because customers lack the money to buy them, but more idle savings are available for investment than business can profitably use, resulting in lower interest rates. According to old-fashioned economic theory, those low interest rates should stimulate business and lead to a recovery. But it doesn't work. The Federal Reserve has proved again and again that by raising interest rates it can convert a boom into a bust, but the reverse is not true.

Perverting the American Dream

In recent years, influenced by pervasive advertising, the misconception has arisen that acquiring wealth is the American Dream. For the settlers who fled religious persecution in the 17th century, as well as 18th and 19th century victims of autocratic oppression and fugitives from Hitler and lesser tyrants in the 20th century, the American Dream has been about freedom, despite the stories about streets paved with gold.

However, in today's welter of television advertising designed to pull all the emotional strings and create a compulsion to buy, it is easy to get the impression that wealth is everything. Ads and publicity for lotteries and sweepstakes proclaim the worship of mammon. One gets the impression it is un-American to be short of cash for the latest fancies. Such promotion of greed may contribute to many of the social problems and to the decline of morality so greatly decried. It certainly encourages people to blame the unfortunate poor rather than to help them.

Ironically, many prosperous people support policies that are not good for their own interests. I once found myself among corporate presidents, bankers, and stockbrokers at a reception in Chicago. This was in 1960 and, learning that I was from my company's head office in New York, these Nixon supporters asked me how his campaign was going in the East. I put on a sad face and revealed that his race against Kennedy was in trouble. How odd it was that these people, whose businesses had historically been more prosperous under Democratic than Republican administrations, were emotionally drawn to the Nixon candidacy against their own interests.

Of course, it is true that a powerful financial elite can enrich its members by robbing the poor. Such can be seen in many of the poorest nations of the third world, where a tiny ruling class lives in luxury beside the misery of the many. Enlightened societies, however, share the national wealth more equally, resulting in a better educated, more motivated work force, and more affluent customers for business. The most prosperous industrial economies have grown from such conditions.

The advantage of general prosperity to everyone is clear, including the rich as well as people of middle and lower incomes. In a poor country with a handful of wealthy rulers, only those at the very top might be better off, and then only in terms of money and power.

Income disparity throughout the world

The 20% of the world's people who live in the world's wealthiest countries receive 82.7% of the world's income; only 1.4% of the world's income goes to the 20% who live in the world's poorest countries, according to figures compiled in 1992 by the United Nations Development Programme (UNDP). The ratio of average income in the wealthiest countries to that in the poorest jumped from about 30 in 1950 to 60 in 1989. Based on individual incomes rather than national averages, the average income of the top 20% was 150 times that of the lowest 20%.

Even in Sweden income disparity has grown. The Swedish Social Democratic Party, in power from 1932 to 1976, had built Sweden's elaborate social welfare system and brought working people into the middle class with greater equity between the wages of women and men than in any other capitalist country. What happened? When Sweden's transnational corporations took a global rather than national view of their interests, the alliance between blue-collar workers and capitalists began to disintegrate, and in 1976 the Social Democrats lost the election to a center-right coalition government.[55]

When they returned to power in 1982, chastened by their defeat, they followed a road later taken by Bill Clinton's "New Democrats" in the U.S. and Tony Blair's "New Labour" in the U.K. Their policies allowed Sweden's industrialists greater profit margins on domestic investment, thus increasing the share of the national product going to profits compared with wages, so that Sweden's industrialists would find it worthwhile to invest at home.

Swedish investors drove up the prices of real estate and other speculative goods. The Swedish banking system lost $18 billion and the bill was passed on to the Swedish taxpayers (like

the U.S. savings and loan bailout). The Swedish Employers' Federation bankrolled think tanks promoting right-wing economics and denouncing the Social Democratic state. While the average Swedish household grew poorer from 1978 to 1988, the top 450 households doubled their assets. Unemployment rose from less than 3% in 1976 to 5% in 1992, not counting another 17% of the workforce engaged in retraining and public employment projects.[56]

Part Three: Propaganda of the Privateers

16. DECENTRALIZATION OF GOVERNMENT

The term “devolution,” meaning decentralization of government (turning over decision-making to smaller governmental units), has been in use in Europe for some time. A similar movement in the United States has sometimes been called “states’ rights.” By whatever name, the principle of shifting public responsibilities from the national government to the states and municipalities has been strongly advocated by the same people who favor privatization (turning over government functions to the private sector). They say that the federal government should do only those things that can’t be done better by the states or the private sector.

Is it true that states are more efficient than U.S. agencies? Many functions handled at the federal level got there only after the states failed to meet a need. The idea behind the movement to shift power from the federal level to the states is that local officials, being closer to the people and their problems, can make better decisions about what needs to be done while avoiding the waste often found in huge federal bureaucracies. Sometimes it is also thought that local officials are less subject to pressure groups and corruption than those in Washington.

The fact is that the federal civil service uses a merit system of appointment and promotion that is rather effective in keeping politics out of the day-to-day operations of federal agencies, while the progress of the states in this direction has been uneven. To all appearances, the lobbying of legislative bodies and elected officials is just as intense at state capitals as it is in Washington, and there is no shortage of political scandals at the state level.

As for operating efficiency, state motor vehicle offices (where the public most often sees state government at work) have functioned so poorly that they have long been an easy target for

comedians. Members of the public who have to deal with municipal agencies for building permits, business licenses, etc., don't usually seem impressed with the efficiency of city hall.

In state after state examples of corruption, nepotism, and favoritism are exposed with such frequency that the efficiency of state government in serving the interests of the general public becomes quite suspect. Still, proponents of devolution claim that the states are less wasteful than the federal government, partly because they must live within their income.

Public and private borrowing

It is often said that households and local governments must balance their budgets, but the federal government just keeps going deeper into debt. That statement, if it ever was true, no longer applies. Marketing pressure has induced consumers to run up huge credit card debt, and one consequence is that non-business bankruptcies rose from 473,000 in 1987 to 788,509 in 1994 (at the same time that business bankruptcies slightly declined from 88,278 to 56,748).[1] By 1996, personal bankruptcies increased to over a million.[2]

As for excessive borrowing by state and local governments, New York State and New York City provide good examples. In the state capital, Albany, a vast expanse of government buildings grew up that rivalled Washington, D.C., also housing a huge bureaucracy. Governor Nelson Rockefeller used tricks devised by John Mitchell (the municipal bonds attorney who later became U. S. Attorney General and went to jail for lying about Watergate) to circumvent the New York constitution. The result was a huge debt that created the financial crises of New York City in the 1970s and New York State in the early 1990s.[3] These are far from being the only state and municipality where debt and high taxes have been problems. For example, voters in California and elsewhere have rejected proposed bond issues and set property tax limits by initiative and referendum.

Apart from efficiency, another argument for devolution is that conditions vary from one state to another. The solutions that work in one state may not be the most appropriate for another state. If the states are allowed to experiment along different lines, each state becomes a laboratory for testing solutions to social problems. Results can be compared and used to guide choices in other states so that all can benefit from each other's experience.

Students of political science have found merit in this concept, and it would not be hard to find examples of good results. California's pioneering efforts to control automobile emissions because of the notorious smog conditions in Los Angeles are a case in point. As another example, the number of states outlawing racial barriers to employment grew rapidly after World War II, as the federal government was slow to establish a peacetime equivalent to its wartime Fair Employment Practices Commission.

On the other hand, the rallying cry of segregationists was "States' Rights," meaning they wanted states with a tradition of segregation by race to continue withholding rights and opportunities according to skin color. Clearly good or bad can result from independent state actions, and a particular practice may be regarded as good by some people and bad by others, as in the case of local differences in liquor laws at the state, county, or municipal level that have existed since the federal prohibition of alcoholic beverages was repealed in the 1930s.

Uneven resources

One problem with devolution is that some states have more resources than others, making it possible for some to afford better programs to meet public needs than others can manage. It was partly for this reason that the federal government started some programs that many states felt unable to finance. The states' combined resources, of course, are the same as those of the nation, but the difference is that the nation can use revenues from individual and corporate income taxes, drawn according to ability

to pay (in theory at least), to meet public needs wherever they exist throughout the states.

The most common method for turning federal programs over to the states has been the use of "block grants." This is similar to the method states use, in varying degrees, to make school resources more equal among counties and cities which differ in their ability to support schools from local property taxes. In neither case are funds distributed completely without strings. It is very questionable whether the separate administration of 50 different state programs plus the federal oversight of compliance with the rules for block grants can result in less total bureaucratic cost than a direct federal program.

The race to the bottom

Block grants almost always add up to less than the cost of the federal program they replace, because they are supposed to save money in the federal budget. States then find that they must supplement these funds from their own revenues if they are going to deliver anything like the services previously provided. Federal support for social services reached a peak in 1978, when almost 27% of state and local funding came from federal grants. As the federal government began shifting greater responsibility to local jurisdictions during the 1980s, federal funding declined until it was only 17% in 1988.[4]

The result has been a more rapid increase in state and local taxes than in federal taxes since the federal government started shifting its responsibilities to the states. In fact, after adjustment for inflation, there was a 30% rise in state and local taxes per capita from 1980 to 1992 while federal taxes per capita dropped 2%.[5] Taxes at lower levels of government, such as state sales and local property taxes, tend to be regressive (harder on the less prosperous) in contrast to progressive rates in the federal income tax.

As taxpayers resist state and local tax increases, pressure develops for states to cut benefits, whether for unemployment, job

training, day care, help for the handicapped, medical treatment, school lunches, or other programs. This tendency is aggravated by the risk that a more generous state will draw poor people from states with lower benefits, while some of its employing corporations may move to a state which has lower taxes.

The logical consequence is for states to compete with each other in cutting services for public needs that were previously handled by federal programs. At the same time, in the absence of prohibitions against local subsidies, states and localities have set up development agencies and used public funds to underwrite private profits as they compete with each other for corporate plants, offices, and headquarters.

Incentives for development

For example, in 1993, South Carolina made a successful bid for a new BMW auto plant. The company chose the location for cheap labor, low taxes, public subsidies, and limits on union activity. The state spent $36.6 million to buy a 1,000-acre tract on which a large number of middle-class homes were located, and leased the site back to the company at $1 a year. The state also paid for recruiting, screening, and training workers for the new plant. In all, it will cost the state $130 million over thirty years. Incentives to corporations often include partial exemption from taxes. In 1957, corporations in the U.S. provided 45% of local property tax revenues. By 1987, their share had dropped to about 16%.[6]

Economist Timothy Bartik, in the December 1994 issue of *the National Tax Journal*, pleaded for federal action to discourage states from competing for jobs with tax and financial incentives, which he declared "are *not* a free lunch for a state or metropolitan area" because they do not create enough jobs and new tax revenue to offset the cost of the incentives.

Editor Bill Bishop agreed, in an article syndicated by Knight-Ridder, citing tax breaks of $116 million per year for 10 years awarded by Tennessee to Columbia/HCA Healthcare Corp. for moving 600 jobs from Kentucky to Nashville, more than $3

billion in future taxes Kentucky traded for a mixed bag of warehouse, office and apparel plant jobs and $150 million for a few thousand jobs plucking chickens, as well as $500 million from New York, $270 million from Louisiana, and $150 million from Michigan each year in deals with business.

Pointing out that the *Wall Street Journal*, the Corporation for Enterprise Development, labor unions, and the National Governors Association all concluded states harm themselves by trading taxes for jobs, Bishop found irony in proposals to give more responsibilities to the states for welfare, health care, housing, etc. "Why?" he asked. "Because the states have proven themselves such conservative stewards of the public good. Yeah, right."[7]

As will be further detailed in discussing monopolies, states and cities have been pushovers for professional sports franchise owners, including the tragic consequence for Cleveland, whose school system lost $32 million in revenues and went into receivership in March 1995, after stadium building cost nearly three times the $275 million that voters had approved.

The case against devolution has been no more effectively stated than in the following excerpt from *The Judas Economy* by William Wolman (Chief Economist at *Business Week*) and Anne Colamosca:

"Measures to improve education, rebuild the public infrastructure, and accelerate R&D will depend for their success not just on government, but on the *federal* government....The fact is that concentrating power in the federal government increases efficiency. The parallel functions of state and federal government are inherently wasteful, leading to a bloated legal system and the duplication of spending in many areas, including education and law enforcement.

"In the economies of our major competitors, the trend has been toward centralization, not decentralization. Passing power to the states also virtually guarantees that capital will prosper, compared to work: competition for capital among the states is certain to lead to special concessions for American and foreign corporations.

"Alexander Hamilton, a hero of the political Right in his time but a man who understood the advantages of centralized power, would have aggressively resisted devolution...."[8]

17. DEREGULATION

It has become an article of faith to some that free markets solve all economic problems, and it is a faith they cling to despite much contrary evidence. Markets are not actually free, of course, when their participants engage in monopolistic restraints, and self-regulation is seldom as good for the public as objective, independent umpiring. The trend toward deregulation since the 1970s started from a legitimate concern about the needlessly complicated bureaucratic rules that are so burdensome to small business. However, it played into the hands of those big businesses that violate the laws intended to protect the public.

Industries that are regulated tend to have a history of abuse that explains why government action was necessary. One of the earliest examples involved the railroads, which set their rates according to "what the traffic will bear." Lower rates applied between major cities, such as New York and Chicago, where more than one railroad served the route, but farmers and others dependent on only one carrier were subjected to extortionate rates.

Remedies on the state level were impossible, partly because the railroads had bought legislators, and partly because laws of some states attempting to restrain the companies were struck down by the U.S. Supreme Court. In 1887 the rails were placed under federal regulation by the Interstate Commerce Commission (ICC). It overcame many abuses, but eventually developed an excess of bureaucracy and paperwork that fueled demands for deregulation. When the trucking industry came along, it was also placed under the ICC and chafed mightily under its regulations.

As the airplane became commercially successful the Civil Aeronautics Board (CAB) was created on the model of the ICC with jurisdiction over routes, schedules, and fares. Critics complained that its regulations were interfering with competition and making flying more expensive.

The bipartisan deregulation movement

Deregulation of airlines in the late 1970s is one of the achievements President Carter claimed for his administration. It set off intense competition among airlines and led to the formation of several new airlines. For a time the new competition brought rates down, at least on some routes, and that is what fans of deregulation cite as evidence for their position. They seldom mention that passengers were packed like sardines with fewer meals or amenities and that people not living in hub cities lost the direct flights they previously enjoyed.

Residents of smaller cities found themselves in a situation similar to that of farmers before railroad regulation. While bargain rates applied between major cities served by more than one airline, hub-and-spoke route systems made it necessary for travelers to reach a hub by driving long distances or to pay high commuter airline fares to the hub and then waste time waiting for the connecting flight. The result for them was longer total time and higher cost for the trip.

Passengers were further inconvenienced by a mind-boggling pricing system varying not only by seating class but also by carrier, day of week, length of stay, advance reservation, etc., and changing so rapidly even travel agents had trouble following the rate changes. A coach passenger on a trip of a few hundred miles within the U.S. could be charged more than the fare for a transatlantic flight. Meanwhile, breaches of maintenance and safety standards were revealed in investigations of airline crashes. A notorious example was ValuJet (since allowed by the FAA to change its name to AirTran), whose plane crashed in the Florida Everglades in May 1996 killing all 110 passengers when illegally transported oxygen canisters burst into flame moments after takeoff.

America's major airlines were able to run their new competitors out of business despite the fact that the new airlines had lower operating costs, and then the airlines that remained raised their rates. The deregulated jungle of air commerce also enabled corporate raiders to plunder and destroy several major airlines, further reducing competition. By 1991 four airlines

(United, American, Delta, and Northwest) accounted for 66% of U.S. revenue passenger miles.[9]

Although President Carter approved deregulation of the airlines, he was not ready to shut down all government regulation. Following the second OPEC oil shock, he recognized the need for action to solve the energy crisis and reduce American dependence on foreign oil. His address to the nation on April 18, 1977, was well received according to opinion surveys and by August 5 the House had finished its work on the omnibus bill.

He recalled in his memoirs, however, that “we encountered far more serious difficulties in the Senate, where the energy industry lobbies chose to concentrate their attention. They launched a media campaign to convince the public that there really was no problem [while] their spokesmen in the Senate were forming a quiet coalition with some of the liberals, who...did not want any deregulation of oil or gas prices; the producers wanted instant and complete decontrol.... For a variety of conflicting reasons...powerful groups rejected the balanced legislation we introduced....Congress adjourned [in 1977] without passing any of the bills....”[10]

As the Democratic administration of Jimmy Carter deregulated the airlines, the Republican administration of Ronald Reagan deregulated the trucking industry, and the Democratic administration of Bill Clinton formalized the end of rail and truck rate regulation under the ICC by abolishing the 108-year-old agency at the end of 1995. The business-friendly climate of the 1980s speeded up deregulation, and not only in regard to transportation. The public was not told in 1980 that the whole package of reforms introduced by Franklin D. Roosevelt was to be dismantled by Republican administrations, but that objective was nearly accomplished in 12 years.

FDR’s banking reforms protected depositors and virtually eliminated bank failures until deregulation in the 1980s encouraged the wheeling and dealing that led to record numbers of failures and the costly bailout of savings and loans by the taxpayers. Also FDR’s securities reforms, establishing the Securities and Exchange Commission (SEC), brought under control the stock manipulations that caused the Wall Street crash

of 1929, but laxness in the 1980s allowed junk bonds, takeovers, golden parachutes, and leveraged buyouts to build fortunes for insiders and speculators at the expense of legitimate investment.

Scuttling the SEC

When John Shad was appointed chairman of the SEC in 1981, for the first time in history a Wall Street executive was brought in to head the agency created to regulate Wall Street. A believer in deregulation, he cut the SEC's staff and during seven years he kept total employment at about or below its 1981 level.

Shad changed the SEC's top priority from corporate practices to individual cheating, and reduced restraints on stock trading and the new speculative stock-index futures. In a series of articles that won a Pulitzer Prize, *Washington Post* reporters David A. Vise and Steve Coll wrote: "Without the SEC peering as closely over their shoulders, some of the biggest investment firms witnessed a breakdown of discipline among their stockbrokers, especially in the area of fraudulent sales practices."

Although Shad had warned the New York Financial Writers Association in June 1984, "the more leveraged takeovers and buyouts today, the more bankruptcies tomorrow," Vise and Coll wrote that several conservative economists in the administration lobbied Shad steadily to make sure he did not push for takeover restrictions.[11]

Commercializing the public airwaves

Just as the head of the SEC in the 1980s had a philosophy counter to the agency's mission, Mark S. Fowler, a former lawyer for broadcasters and a strong proponent of deregulation, was appointed to head the Federal Communications Commission (FCC). "Television is just another appliance," said Fowler. "It's a toaster with pictures." He took the position that it was time to "move away from thinking about broadcasters as trustees. It was time to treat them the way almost everyone else in society does—that is, as business."

He defined his mission as "pruning, chopping, slashing, eliminating, burning and deep-sixing" as many as he could of the FCC regulations. He abandoned the rules requiring a minimum portion of airtime to be devoted to news and public service programs (actual commercial TV program time for children dropped from 11.3 hours per week in 1979 to 4.4 in 1983), increased the amount of advertising a station could run in each hour, abolished a log-keeping requirement that was helpful for checking on programming offered, and got Congress to raise the limit on the number of TV stations a company could own from five to twelve.

Fowler gave every possible assistance to Rupert Murdoch, the Australian-born media mogul, in acquiring stations beyond legal limits to build the Fox Broadcasting network. Between 1982 and 1984 the average of price of a television station doubled from $12 million to $24 million, and the total price for all stations sold in 1983 and 1984 reached $5 billion, or 60% more than the previous two years. This was good for station owners, but their financial interest was clearly put ahead of public trust.[12]

The "Fairness Doctrine," in effect since 1949, had required broadcasters, as a condition of their licenses from the FCC, to cover some controversial issues in their community, and to do so by offering some balancing views, allowing equal time for each side of a controversial issue or political campaign. It was abolished in 1987 with the result that only the two major parties now get a chance to present their views, and biased broadcasters can push a one-sided viewpoint for hours at a time. President Reagan vetoed, and President Bush killed by threatening to veto, subsequent congressional measures to restore the Fairness Doctrine.

Wealthy station owners quickly moved to push their conservative political views, especially through talk radio. Rush Limbaugh is the prime example with an open mike three and a half hours every weekday on 660 radio and 250 television stations to blast those he considers too liberal. In 1993 Limbaugh's daily on-air crusade generated thousands of calls to Washington and helped derail congressional action to restore fairness.[13]

Meanwhile, the courts, in what former FCC Chairman Newton Minow later called “a moment of madness,” overturned the standards for children’s TV that the National Association of Broadcasters had developed in 1952. The 1982 decision held ironically that the antitrust laws, which were not preventing the epidemic of broadcasting mergers, somehow prohibited the code’s limits on commercial time in children’s programs. In a 1998 interview, Minow declared television programming, particularly for children, even bleaker than in 1961, when he described it as a “vast wasteland.” He added, “There is more violence, more sex, more unpleasantness than ever before.”[14]

Broadcasters are quick to invoke freedom of speech and of the press, but broadcasting differs from print media because of the limitations of the radio spectrum that make television and radio stations government-sanctioned private monopolies. Throughout the world broadcast frequencies are controlled and allocated by governments—which is necessary to prevent transmissions from jamming each other. In the United States each station was granted the exclusive use of a particular frequency or channel at a specified power and geographical location, a privilege subject to compliance with public interest requirements under regulation by the Federal Communications Commission (FCC).

Periodically stations come up for license renewal and are supposed to show that they are using their monopoly for the benefit of the public. This has become a meaningless ritual with renewal a foregone conclusion, especially in the mania for “deregulation.” This has created enormous profits for the monopolists, who have sold for millions of dollars the licenses that were originally awarded for nominal amounts. It reminds me of New York City taxicab medallions for which the city received a few dollars, but which are sold privately for $50,000 or more.

Law enforcement ignored in other agencies

The Federal Trade Commission (FTC) and the Antitrust Division of the Justice Department, which are the principal agencies for enforcing the antitrust laws, have done little to stop mergers, either during the 1980s or since then. Attorney General Robert Abrams of New York, explaining why he and colleagues

from the other 49 states criticized the Reagan administration's antitrust policies, said, "Most of these massive combinations—in oil, steel, airlines, and other basic industries—would never have passed muster under any other administration, be it Democrat or Republican."

A commissioner of the Federal Trade Commission testified that a combination of severe budget cuts and the more permissive regulatory climate had left that agency "gaunt and bloodied" and that in the Reagan period merger filings jumped to more than 320% of their fiscal 1980 level. Similar laxity at the Federal Home Loan Bank Board, charged with overseeing regulation of the nation's savings and loan industry, was behind the crisis and bailout described in another chapter.[15]

Despite such failures of the market as described above, proponents of further deregulation kept proclaiming that government regulation was the problem and that a free market would make the economy well. Correctly seeing that *unnecessary* regulation by government is wasteful and stifles progress, they were reluctant to admit that some control is beneficial to maintain a level playing field among large and small entrepreneurs and to prevent the profit motive from running roughshod over the best interests of the public.

When regulations become overgrown and too complex they need to be pruned back and simplified. On the other hand, there is need for an umpire to make sure there is fair play. Where public health and safety are involved, or a natural monopoly (public utility) situation exists, or people trust their money to financial institutions, market forces cannot be relied on to make companies do what is right.

Deregulation regardless of party in power

The deregulation rush did not end with the change to a Democratic administration, as business obtained further deregulation even when President Clinton had a Democratic majority in Congress. Antitrust enforcement remained weak as huge mergers continued, including Lockheed and Martin Marietta which formed the largest U.S. defense contractor.

The election of a Republican Congress in 1994 was interpreted by its leaders as a mandate to speed up deregulation. The candidates had posed on the Capitol steps and publicly issued a "contract" promising to pass certain bills if the Republicans won a majority of seats. Although polls showed few voters were familiar with this agenda, the new House Speaker, Newt Gingrich, attempted to bring to a vote each of the ten items in the Contract, including "No. 8: Cut taxes on capital gains and further deregulate business." Deregulation sounded good, as everyone hates senseless regulations that hamstring business, but what about sensible and necessary regulations?

Incredibly, the new Congress actually invited industry representatives and lobbyists to come into the Capitol and draw up the deregulation laws. The resulting bills were introduced by House members who, in some cases, were demonstrated to be unfamiliar with the contents of the proposed legislation.

The new laws being inserted into the budget or designated "Contract" bills included weakening Truth in Lending and Truth in Savings, limiting recourse against securities fraud, removing federal protection of nursing home residents, allowing corporations to take reserves out of worker pension funds, penalizing ordinary persons for pursuing justice in the courts, cutting services that enable the elderly to live independently, and expanding the giveaway of public lands to big lumber and oil companies.

Environmental hits

Congress made it easier for polluters to get away with violating laws by cutting the Environmental Protection Agency's fiscal 1995 budget by 10%, with further cuts for 1996 and forbidding various EPA actions on such matters as carcinogenic radon in tap water and information required from chemical manufacturers about release of toxins into the environment.

While key administration officials and environmentalists were excluded from the a House committee's deliberations on amending the Clean Water Act, a group of corporate representatives, the "Clean Water Task Force," including Allied Signal, General Motors, the Chemical Manufacturers Association,

and the American Petroleum Institute, were allowed to set up an office adjacent to the House floor to write amendments during the floor debate.

They produced a bill that would require federal agencies to base all public health and environmental protection primarily on economic issues, resulting in a 223-step review of every new regulation and federal cleanup, including toxic waste sites and oil spills. It would provide endless opportunities for delay in the courts with 60 new bases for judicial challenge, according to the Natural Resources Defense Council.[16]

Open season on logging

Attached to a disaster assistance bill passed by Congress in August 1995 and signed by President Clinton (who later said he didn't realize what its effect would be) was the Clearcut Rider, which for 18 months suspended environmental laws and barred citizens from enforcing them in court. Although the rider was only supposed to be for the logging of dead and diseased trees, it was used as a loophole to clearcut healthy trees from Alaska to Alabama.[17] According to the Sierra Club, there are 377,000 miles of logging roads in our National Forests, all paid for by the taxpayers for the benefit of logging companies to whom government agencies sell timber at cut-rate prices and at a loss to the taxpayers.

The logging rider provided that any procedures followed by federal agencies for timber sales under these programs automatically satisfied the requirements of federal environmental and natural resource laws—regardless of how inadequate these procedures might be and despite any conflict with important provisions of the Clean Water Act, the Endangered Species Act, the National Forest Management Act and the National Environmental Policy Act.[18] After the 18 months open season expired, lobbyists were hard at work trying to get it renewed. Just as the clearcut rider was camouflaged by its attachment to a disaster assistance bill, other bills in 1995 masqueraded under high-sounding titles.

Deregulating guns and police terror

Under the misleading name of the "Taking Back Our Streets Act" Congressional leaders proposed to remove the ban on assault weapons (contrary to the wishes of 69% of the public) and to allow police to enter and search homes without warrants. In a published letter at the time, I suggested, "perhaps we'll need assault weapons to defend our homes against SWAT teams that come to the wrong address by mistake."

Although allowing manufacture and sale of assault weapons to all comers could be considered deregulation, it is hard to see how expanding police powers would fit the declared objective of "getting the government off our backs."

Protecting the guilty

Under the imaginative title of the "Job Creation and Wage Enhancement Act," a bill that also included a capital gains tax cut provided a redefinition of the Constitutional provision against taking private property without compensation. It introduced the weird concept, called "takings," that polluters and violators of health and safety rules, among other commercial interests, must be paid by the government for their inconvenience.

Distorting common sense, the "Common Sense Legal Reform Act" would have sheltered corporations and doctors from responsibility for their faulty products or negligence, as the tobacco industry later tried to gain immunity from lawsuits in 1998 by Congressional ratification of proposed settlements of state lawsuits.

The "Private Securities Litigation Reform Act," which Congress passed over President Clinton's veto, made it even more difficult to sue corporate management, their accountants and other consultants in federal courts for defrauding investors. It is now harder to collect from securities cheats, such as those involved in the great S&L debacle—a strange sort of reform.[19]

Undermining worker safety

A lobbying campaign against the Occupational Safety and Health Administration (OSHA) earned United Parcel Service (UPS) a place in *Multinational Monitor's* "1995 Lobbying Hall of Shame." With the highest injury rate among trucking and delivery companies, 15 lost-time injuries per 100 full-time workers, UPS has been cited by OSHA for more than 1,300 safety violations in the 1990s. Naturally, UPS joined the deregulation movement by lobbying Congress to cut OSHA's budget and bar the Agency from developing a long-anticipated ergonomics rule intended to protect workers from repetitive stress injuries and heavy lifting.

The UPS political action committee spent the maximum legal contribution of $5,000 on each member of Congress coming to its "meet and greet" sessions in 1995, consisting of food, drink, and a donation of $4,550. It led the corporate pack with outlays of $3 million in three years.[20]

Other deregulation measures in 1995 aimed to repeal laws that protect nursing home patients from abuse, to undercut health and safety (such as meat inspection), and to allow domination of TV by cartels and foreign interests. Not all these efforts succeeded, of course, but a considerable start was made on deregulation, weakening the capability of the federal government to act as umpire between corporate power and the public welfare. Efforts were made to extend the start already made to have strong state and local control of monopolies preempted by weaker federal regulation, as had been done when federal action in the 1980s blocked local rate limits on cable television.

Wholesale deregulation of communications

Unlike many other deregulation bills, where the Republican-controlled Congress faced the opposition and possible veto of a Democratic president, communications legislation turned into a lovefest. Upstaging Republican deregulation plans, President Clinton and, especially, Vice President Al Gore, enthused about the "information revolution" and building a communications network "for the Twenty-first Century." It was February 1996 when the Telecommunications Reform Act was

passed by Congress and signed by the President. (Notice how often legislation is self-described as reform!) Most of the media attention was devoted to the V-chip, a device that may be somewhat useful for parents to control TV watching but did nothing to improve the quality of programs.

Some more significant parts of the bill, obtained by the communications industry that had donated over $50 million to politicians in the previous 10 years, got less attention. They included:

- Allowing mega-corporations to dominate the communications and entertainment industries.
- Permitting the "Baby Bell" phone companies to recombine and to enter the long-distance telephone business.
- Overriding state and local regulation, even to the extent that cellular telephone towers can be erected in neighborhoods in defiance of local zoning laws.

Many people think commercial radio and television in America are free, unlike countries where license fees are charged to receive programs from a government-controlled source. Not true. The cost for us is in the many commercial messages that interrupt the programs. Economists generally agree that there is no "free lunch" and this is a good example of their point that there are always strings attached.

Old-timers remember that early radio had few commercials, but they gradually increased, then FM at first was almost commercial-free, and the early days of television had long programs with a single sponsor whose commercials came at the beginning and the end. The big increase occurred after the Reagan administration in its enthusiasm for deregulation had the FCC remove the already generous limit on the number of commercials, saying it was not necessary because broadcasters were using less than the limit.

Further increases continued in the 1990s, according to an April 29, 1998, Associated Press report of a study commissioned by two advertising groups. It found that prime time TV in November 1997 had over 11 minutes of commercials per hour,

compared with about 9 1/2 minutes six years earlier, and network promotions plus public service announcements brought the total clutter to more than 15 minutes per hour. The ads had grown shorter but there were more of them. In daytime television there were nearly 20 minutes of interruptions per hour.

An agency spokesman said the networks had to increase the advertising carried to keep up their revenues because of a decrease in viewers. The industry has discussed many theories to explain the loss of viewers, but seems unwilling to think it could be at least partly due to advertising saturation and/or the decline in quality of programming.

Less news and more ads

I had begun doing my own count of the ads and promotional spots on the early evening half-hour news shows of three networks in February 1995, which I repeated at the same time of the year in 1996, 1998, and 1999. I found that the viewer had to endure more than one ad for each minute of news. In 1995 and 1996 these ads and announcements averaged 29% of the total time, which grew to 37% in 1998 and 1999, leaving only 63% for actual news.

The average number of such interruptions in each half hour grew from 23 in 1995 to 26 in 1999, and the time devoted to ads and promos increased from about 9 minutes per news show to more than 11 minutes, leaving less than 19 minutes for news. Generally, there was little difference among ABC, CBS, and NBC, but February 6, 1998, was a special case. CBS spent slightly less time on ads than ABC and NBC in that day's news program, but devoted over 6 minutes of news time to an Olympics preview, promoting their start of Olympics coverage later that night, which in turn was fractured and saturated with commercials.

Over these years, not only was less time left for news, but its quality also suffered. Some evidence of the deterioration of TV news was tallied by Media Monitor in Washington during the month of January 1998, which found that the story about White House intern Monica Lewinsky and President Clinton (56% of the

time from unnamed sources) took up 34% of total airtime on the newscasts of ABC, CBS and NBC. This was more time than they devoted altogether to the Iraq crisis, the winter Olympics, the Pope's visit to Cuba, and the disasters attributed to El Nino![21] This was before the impeachment of the president by the House of Representatives later in 1998 and his acquittal by the Senate in 1999.

The ultimate in commercial saturation, of course, would be 100%, and that is what is called an "infomercial," typically a half hour or more of paid sales pitch disguised to look like a regular program (something not allowed before the 1980s deregulation). Then there are the home shopping stations, totally commercial, which the FCC ruled on July 2, 1993, cable TV operators *must carry* if the local stations request it. Commissioner Ervin Duggan dissented: "Has our concept of the public interest become so denatured—so attenuated that virtually anything goes?" The home shopping channel operator, QVC Inc., even attempted to take over the CBS network.

Should the market regulate public utilities?

When an industry tends toward monopoly, two possible remedies exist. Either the government can enforce antitrust laws to restore competition, or it can decide that the business is a natural monopoly and regulate it as a public utility, such as telephone and electric power utilities. When Ma Bell was broken up, it was wisecracked that the courts targeted the only monopoly that was working well. AT&T kept introducing improvements and long-distance rates kept coming down because federal regulation prevented overcharging.

The pressure to break up AT&T came from large corporations who wanted faster introduction of sophisticated services. It is uncertain whether rates would have come down as much from scientific progress without competition from MCI, Sprint, and others. Many consumers have found the conflicting claims, deceptive promotional gimmicks, and barrage of advertising an unnecessary addition to the confusion of modern life. After AT&T's monopoly of telephone service was broken, a

competitive war broke out for the long-distance telephone business. Although MCI and Sprint offered the biggest challenge to AT&T, many small companies vied for a piece of the business.

One outcome was an annoying snarl in the routing of calls. As numbers became depleted in various area codes, due to demand for cellular phone and fax lines as well as population growth, parts of each area had to be switched to a new area code. Some long distance calls were not getting through to the new codes.

For example, the North Carolina Piedmont Triad (Greensboro, Winston-Salem, and High Point) had to change from area code 919 to 910 in 1993 and change again to 336 at the end of 1997. Both times residents found that calls directed to the new area code were resulting in such messages as "Your call cannot be completed as dialed." A BellSouth spokesman explained in a newspaper interview that multiple phone companies are involved and each must reprogram its computers to recognize the new area code. He gave the example of a New York City call first handled by NYNEX, passed to a long-distance company, and then relayed to BellSouth in Greensboro. If any company in the chain had not reprogrammed its equipment, the call would not go through.

There were 34 new area codes created in North America in 1997, requiring adjustments by the hundreds of local, long-distance, and cellular companies, as well as thousands of private telephone systems. There is a grace period of several months when the old area code will still work. The assurance given by a telephone company spokesman sounded a little weak: "Experience has been that the vast majority of telephone companies will take care of the matter before the end of the grace period."[22]

Another result of long-distance telephone deregulation was the onslaught of dinner-time telemarketing calls urging patrons to change their long-distance carrier. Even worse, sometimes the change was fraudulently made without the subscriber's approval, and spurious, misleadingly-described charges appeared on phone bills. These practices became so widespread they gave rise to such terms as "slamming" and "cramming" in the trade and the popular media, but corrective action by government seemed slow to come.

Whose electricity do you want to buy?

State legislatures have been urged by business interests to undercut public utility regulation on the theory that the market can do a better job of allocating resources. That argument is a good one against some kinds of government regulation, but not in cases involving a natural monopoly.

Electric power is a prime example of a natural monopoly because power lines can be run to users only through rights of way controlled by local government. It would not be feasible for numerous competing power companies to string multiple sets of wires. State public utilities commissions have been created to prevent the one power company serving a given area from using monopoly power to charge unreasonable rates.

Bills offered in many states would require local electric utilities to route power over their lines from various generating companies and make consumers choose a power source, as they now choose a long-distance telephone company. The electricity would still travel over the same wires (which don't know or care where the power originated), so only a bookkeeping change would be involved. Pressure for deregulation of electric power comes from large industrial users with great bargaining power to get preferential rates. Individuals and families would have little influence, but the same marketing confusion as telephone service.

Proponents of deregulation claim great benefits from deregulation of long-distance telephone service, airlines (where rates may be cheaper between major hubs but sky-high elsewhere, and passenger safety has come into question), broadcasting (now dominated by trash, reruns and commercials), and financial institutions (one result of which was the huge taxpayer bailout of savings and loans). They have urged Congress to leave electricity to the states, some 46 of which, at this writing, are considering changes. While the public may be able to follow, to some extent, what Congress is doing, private interests have the organization and political leverage to get their way at the state level before voters know what's happening.

The "Electric Consumers Resource Council," for example, sounds as if it stands up for the general public, but the "consumers" are big industrial users of electricity, such as General Motors, Texaco and Procter & Gamble. The "Edison Electric Institute" is backed by the profit-making utilities. One university study touting the benefits of electricity deregulation was financed by Enron, a giant energy company based in Texas.[23]

Opponents of deregulation point out that it might increase air pollution. The market would encourage companies to keep producing power from old, but inexpensive, generating plants, which are allowed not to clean up under a "grandfather" exemption.[24] A further problem is that of "stranded assets," the generating plants of existing electric utility companies (including some for which municipalities still have outstanding bonds that will need to be paid off). The taxpayers are in danger of being made to pay these costs, while industrial customers (but not private homes) get the benefit of lower rates from power companies with cheaper but more polluting generators.

18. PRIVATIZATION

Believers in the superiority of private enterprise and free markets go too far when they insist that the private sector is better than government at everything. Their ideas received great acceptance in recent years and have been tried out in many areas where one might have predicted the failures that occurred.

The term "privatization" was frequently heard in the eighteen years of Conservative party rule in Great Britain under Prime Ministers Margaret Thatcher and John Major. Previous governments had made public enterprises of such productive facilities as coal mines and automotive plants, whose recurring deficits imposed a drain on the national treasury. After these enterprises were privatized (sold off to private companies), other public properties were also sold to the private sector.

Shortly before the Conservatives (or Tories) lost in the 1997 landslide to the Labour Party under Tony Blair, British Rail (BR), the public corporation originally established to reform troubled rail operations of private railroads, was sold off in pieces to private companies that would operate portions of the rail network.

Somewhat earlier, public water and gas systems had been privatized, rates went up and top management got big raises. To recapture windfalls that occurred, the new Labour government promptly enacted a special tax to be used for education. Still, in its new image that won the election, "New Labour" promised not to return to public ownership the enterprises privatized by the Tories, and was even open to further privatization.

In America, as in Britain, many politicians and economists friendly to the business community began to preach the doctrine that private enterprise is always more efficient than government. The push in the U.S. at first was for deregulation rather than privatization, as the government had already quasi-privatized the Post Office and had never become involved in

running businesses to the same extent as Britain (with its money-losing coal mines and British Leyland motor cars and trucks).

As a corollary to the mania for budget balancing, it became fashionable to advocate reducing the size of government. Even Democratic president Bill Clinton in a State of the Union speech announced the "end of big government," while Republicans complained he had stolen their issue. Commissions, committees, politicians, and journalists have all compiled evidence of the waste and inefficiency of government bureaucracy, and elections have been won on promises to cut back overgrown agencies.

Most of the attention has been on the federal government, although similar horror stories are easy to find at the state and local level. On the federal level, the administration of Medicare had, for many years, been divided into regions that were contracted out to various insurance companies, and there is a strong movement to privatize Social Security to some degree. In some localities private companies were being given contracts to collect the garbage, operate prisons, and/or run public schools.

Despite all the oratory, there has so far been little evidence of improvement in efficiency, and the size of government has continued to grow, as measured by combined per capita expenditures of all levels of government, which grew in percentage of GDP and in dollars (even after adjustment for inflation) from 1980 to 1995 as shown in the following table (totals for later years are slow in coming).

TABLE 7.
FEDERAL, STATE AND LOCAL GOVERNMENT TOTAL EXPENDITURES IN RELATION TO GDP[25]

Year	GDP (nominal) per capita	Govt.exp. (nominal) per capita	Gov.exp. as % of GDP	Govt.exp. in 1997 dollars per capita
1980	$12,226	$4,232	34.6%	$8,233
1990	22,979	8,921	38.8%	10,959
1995	27,605	11,630	42.1%	12,242

Involuntary servitude

Not only have some jurisdictions turned over the operation of prisons to private companies, which in itself can make human rights advocates uneasy, but prisoner labor is being used to create profits for private companies. More than 100 companies in 29 states contract out the use of inmates as part of a Department of Justice program. Prison operating companies, such as Corrections Corp. of America, advertise inmates as an ideal labor force.

Wackenhut operates Lockhart Correctional Facility in Texas, where prisoners work for three different corporations assembling circuit boards, manufacturing eyeglasses, and making valves and fittings. Under the name of Lockhart Technologies, U. S. Technologies began using prison labor 45 days after selling its Austin electronics plant and laying off 150 workers. In Ohio, prison inmates assembled Honda parts for 35 cents an hour until the United Auto Workers got the practice stopped.[26]

Government has no monopoly on bureaucracy

Politicians enjoy cheap shots at government workers, who generally have meager resources to fight back. While some government underlings are bravely fighting a hopeless battle

against backlogs of work, other persons, usually higher in government agencies, can always be found wasting time and money for little or no benefit to the taxpayers. Agency heads sometimes enjoy about as many junkets as Senators and Representatives to the world's resorts and tourist meccas.

Without for a moment questioning the wisdom of correcting government waste and abuse, we can see a fallacy in claiming that these inefficiencies prove the need to turn government functions over to private industry. Proponents of privatization make no mention of similar inefficiencies that are widespread in large private corporations. The success of the "Dilbert" cartoons depends on readers recognizing idiotic management policies as familiar in their own experience.

To take one example from the wild world of Wall Street wheeling and dealing, consider the $25 billion leveraged-buyout (LBO) of RJR Nabisco by Kohlberg, Kravis, & Roberts (KKR) in 1989. KKR reportedly collected nearly $500 million in transaction, advisory, and other fees.[27]

Like other corporate bosses spending the stockholders' money lavishly, RJR Nabisco's CEO, F. Ross Johnson, a principal in the record-breaking LBO, maintained a fleet of 10 planes and 26 corporate pilots, known informally as "Air Nabisco," and built a palatial hangar in Atlanta to house them.[28] Johnson and other top executives received "golden parachutes" in the end, and millions of dollars were passed out like dollar-bill tips to numerous law firms and brokerage houses as "fees." The company ended up enormously in debt.

(In March 1999 RJR Nabisco revealed plans to sell its international tobacco operations to Japan Tobacco Inc., helping to pay off some of its $9 billion of debt, and to split RJR's domestic tobacco operations and Nabisco's food business into separate companies.)

Such profligacy is typical of huge corporations and the people who buy, sell, and run them. These pillars of private enterprise not only resemble privileged politicians in their conduct, but also provide most of the financial support to politicians and to propaganda mills called "think tanks." Those

politicians and think tanks proclaim the efficiency of private enterprise while denouncing waste in government.

The private sector is unfortunately not a free market. Private enterprise as conducted by giant multinational conglomerates restricts trade in ways that have nothing to do with the competitive supply-and-demand economy of Adam Smith.

Government spin-offs

It may be useful to contrast the administrative record of Medicare with Social Security, although not directly comparable. Social Security is administered by the federal government at a cost of less than 1%, and most seniors have found the staff of Social Security offices very helpful. Extremely few abuses have been discovered, mostly concerning claims for disability benefits.

Medicare, on the other hand, is administered by private insurance companies which are responsible for one or more regions and are paid by the government under contract. Seniors and their physicians are frustrated by a bewildering maze of forms and procedures. Year after year fraud and abuse have remained a scandal, although estimates have varied as to its extent.

Medicare fraud was totalling between $20 billion and $40 billion annually, according to Gross.[29] The agency that investigates Medicare and Medicaid fraud recovered merely $70 million in 1992, and the agency was closing offices and curtailing its operations because of budget cuts, according to *AARP Bulletin*, May 1993. Besides outright fraud, which may be hard to prove, improper billing is rampant.

The latest government attempt to deal with this problem is Operation Restore Trust launched by President Clinton in May 1993, which collected $187 million in two years ($10 for each dollar spent, but less than 1% of the losses), according to *Secure Retirement*, which also cited the HHS Inspector General's audit showing an estimated $23 billion, or about 14% of all fee-for-service benefits were paid for services not medically necessary, billed incorrectly, or not even covered by Medicare.

That did not even include intentional fraud such as phony records or kickbacks. For example, Medicare was billed over $3

million by a California nursing home for nonexistent supplies, nearly $71 million in excessive charges by a Florida supplier to nursing homes, and hundreds of millions of dollars by equipment suppliers who charged for expensive pumps while delivering cheap ones. A California psychiatrist collected from Medicare several times for the same nursing home visit.

The public is told that it should hold down medical costs by quizzing doctors about their fees, avoiding unnecessary and expensive treatments, and questioning any doubtful charges on Medicare or private insurance. Isn't it a little hard to imagine patients, especially elderly ones on Medicare, disputing a procedure the doctor has said is necessary or even desirable?

Despite the enormous amount of fraud in Medicare billing, the system has made it difficult for the patient to blow the whistle. A typical notice sent to the patient reports on a hospital stay, "Medicare paid all covered services except: $716.00 for inpatient deductible." Please note that the patient is not even told how much the hospital billed or how much Medicare money the hospital collected. Studies have revealed that the insurance companies under contract to handle Medicare paperwork for the government have been very lax in allowing fraudulent billing to be paid.

Unfortunately, the contracts that private companies have for processing claims apparently include no responsibility for preventing or detecting fraud. The vice president for audit of a major Medicare contractor commented, when asked about investigating fraud: "There is no reward for finding fraud....We have to think about our shareholders." He pointed out that the company suffered no out-of-pocket losses. Another official of the same company explained that fraud losses "are not operating expenses. It's just someone else's money that's passing through."[30]

Even with the weaknesses just discussed, Medicare contradicts in another way the conventional assumption that private enterprise is more efficient than government. Insurance companies calculate a "loss ratio," the ratio of benefits paid to premiums charged. The higher the ratio the more efficient and

more favorable to the consumer, although often less profitable to the company.

The Medicare system, run by the government using private contractors for regional administration has a loss ratio in the 90% range; that of Prudential private medigap policies endorsed by the American Association of Retired Persons (AARP) is 78%; that of the companies which sell their medigap policies on television is usually a little above or below 50%.[31]

Altruism beats market incentives

Advocates of privatization have great faith in financial incentives, and they predicted that if payment were made to blood donors in England the blood supplies would increase. The comparison of British and American blood banks in Richard Titmuss's classic, *The Gift Relationship* (1970), showed the British system, which prohibited the sale of blood, to be far superior to the American system, where nearly a third of blood products came from professional donors (the rest from voluntary, nonprofit institutions coordinated under the Red Cross).

From its establishment in 1948 to 1967, the British system increased annual donations from 9 to 19 per thousand of population, and the blood supply increased by 77% in England and Wales between 1956 and 1967, but only 8% in the United States. Professor Titmuss concluded that privatization of blood is riskier to recipients and donors, and in the long run produces greater shortages of blood. Paradoxically, he noted, "the more commercialized a blood distribution system becomes (and hence more wasteful, inefficient, and dangerous) the more will the gross national product be inflated." This is yet another example of the errors in measuring national product discussed in an early chapter of this book.[32]

Public school privatization

It is hard to dispute the contention that the nation's public schools in general are falling short of any reasonable standards, even including their own stated objectives. There is less

agreement as to the best solution. Advocates of privatization offer two possible solutions: furnish parents government vouchers to pay for enrolling children in private schools, or contract out the operation of public schools to private enterprise.

The voucher proposal runs into the problem that private schools may only accept well motivated and well behaved students, leaving the public schools with a higher percentage of difficult pupils than they already have. A further problem is that religious groups may try to use the voucher system to get public subsidies for teaching their sectarian doctrines.

The other proposal raises the question whether private contractors can operate the public schools more efficiently than public agencies when they face the same obstacles and are trying to extract a private profit from the available funds.

The Baltimore and Hartford experiments

Early in the 1990s a Minnesota-based company, Educational Alternatives, Inc. (EAI), told Baltimore it could run the city's public schools better and got a contract from Baltimore to run nine of them at a cost of $18 million more than the city was planning to spend on them. Although the schools got cleaner, educational results in the first two years of this privatization experiment were disappointing.

Test scores dropped at the EAI schools while rising in other Baltimore city schools. Special education programs were slashed as EIA fired half of the qualified teachers. While attendance improvements were made in the rest of the city's schools, EAI schools lagged. An independent study by the University of Maryland concluded that EAI was spending more money per pupil than other Baltimore public schools, but their pupils weren't achieving more.[33] Three and a half years into the five-year contract, the school board in Baltimore voted unanimously to dump EAI.

In 1994 the city of Hartford, Connecticut, contracted with the same company, EAI, to run all its 32 schools and $200 million budget. The company was to keep half of any money it could save. In spite of overcrowded classrooms, EAI submitted a budget

that called for firing almost 300 teachers while planning to have the city pay $1.2 million for expenses of its top executives. For these and other reasons Hartford decided to take back control of 26 of their 32 schools.[34]

Removing the "non-profit" from hospitals

Hospitals began in some cities as municipal services. In other areas health care facilities grew up as cooperative community enterprises. Civic minded members of the public, including physicians and nurses as well as business leaders and ordinary citizens, contributed their time and money to organize and develop non-profit community hospitals.

Government's contribution to community hospitals was in the form of tax exemption. No federal, state, or local taxes were imposed. Hospitals were exempt from income tax because they were non-profit, and they generally were exempt from sales taxes and real estate taxes as charitable non-profit organizations. Their financing was assisted by tax-free bonds, and government also assured hospitals of a considerable cash flow from Medicare and Medicaid payments.

Private hospitals had been rare until about 1970, when promoters saw the potential for profits from Medicare and Medicaid payments. New issues appeared on the stock exchanges and over the counter for companies building chains of hospitals and nursing homes for profit. This resulted in excess bed capacity and duplication of specialized equipment, which led to under-utilization and higher unit costs. The costs were used as justification for charging more to the government.

By 1995 non-profit hospitals had become an endangered institution. Many were being taken over by the two largest hospital chains, both of which have been charged with health-care fraud on a large scale.

Commercializing Blue Cross

Another non-profit area raided by commercial opportunists consists of the various state Blue Cross/Blue Shield

organizations. They were founded in the Great Depression by doctors and hospital administrators so that people (and their employers) could pay premiums before they got sick and the money would be there to pay the hospitals and doctors in time of need. In the process, the Blue Cross organizations accumulated considerable assets that are coveted by private individuals and corporations.

It is possible for Blue Cross executives and outside investors working with them to become overnight millionaires by capturing those assets. Blue Cross of California converted from its non-profit status, taking the name Well Point, and then merged with for-profit Health Systems. As part of the deal, however, the State of California required two new grant-making foundations with a total endowment of $3.3 billion transferred from the nonprofit Blue Cross of California.

Georgia's legislature, on the other hand, passed a law in 1995 that made it much easier for the state's Blue Cross and Blue Shield plan to avoid using its assets for any public benefit and to provide its executives and investors with a windfall amounting to hundreds of millions of dollars.

In March 1996 the hospital chain Columbia/HCA announced plans for a joint-venture agreement tantamount to purchase of Blue Cross of Ohio. The top three executives of the non-profit Blue Cross and an outside counsel are to receive $19 million for a non-competition pact and agreements for future consulting. Blue Cross assets include $230 million in reserves. For 85% of all the assets and an option to purchase for one dollar the remaining 15%, Columbia is to pay $300 million (out of which it is to be insured against losses up to $30 million annually).[35]

In other states, such as Colorado, Maine, New Jersey, and North Carolina, Blue Cross plans have attempted to change state laws to make conversion easier and to keep contributed assets in the new private companies. Virginia's Blue Cross plan got a law allowing it to convert by giving the state $175 million for the state's education budget. The amount was not independently assessed and was probably much less than fair market value. The executives of Blue Cross plans and hospitals in these conversions and their lobbyists are typically well paid and well connected.

None of this was possible until, in June 1994, the national Blue Cross and Blue Shield Association voted to allow members to become for-profit companies.

Trying to defuse opposition to state legislation in behalf of Blue Cross and Blue Shield of North Carolina, its chief executive officer, Kenneth C. Otis, wrote a signed article published February 1, 1998, in the *Greensboro News & Record*.

He disputed a column in the paper that stated the bill would have allowed Blue Cross to convert to a profit-making investor-owned company. "The state gave BCBSNC the authority to convert 45 years ago," he claimed. "Last year's bill...simply provided a road map so taxpayers' and customers' interests would be protected if we convert later." Blue Cross had hired a telemarketing giant to make calls urging subscribers to favor the bill, an action that drew criticism but was not illegal according to the N.C. Secretary of State's office.[36]

Privatization not necessarily more efficient

The claimed efficiency of commercial operation is belied by studies of the California Medical Association reporting that in 1995 the newly converted for-profit California Blue Cross plan spent only 73% on health care versus 27% for administration and profit. In the same year, the state's largest non-profit, the Kaiser Foundation Health Plan, devoted 96.8% of its revenue to health care and retained only 3.2% for administration and income. Likewise among those health maintenance organizations (HMOs) where medical care got the highest proportion of revenue, seven out of the top ten were nonprofit in 1994; nine out of ten in 1995.[37]

Making the point that for-profit does not necessarily equal more efficient, Robert Kuttner, co-editor of *The American Prospect*, wrote in the May-June 1996 issue: "It was not old-fashioned savings and loans, which were nonprofit mutuals owned by their depositors, that turned speculative and cost the taxpayers hundreds of billions of dollars. That debacle occurred after most S&L's converted to profit-making institutions....

"In New York State, where the business of home care has become a lucrative profit center for private businesses, the hourly

cost billed to Medicaid has climbed to nearly a hundred dollars an hour, of which the nurse's aide gets less than $10. Nonprofits do the job more ethically and efficiently...."[38]

Health Maintenance Organizations (HMOs)

The Clinton plan for universal health care proposed to put a brake on skyrocketing costs by encouraging health maintenance organizations. The plan was soundly defeated in Congress by the propaganda and lobbying campaigns of the health care industry, but HMOs have since flourished as the form of medical insurance preferred by many companies for their employees.

Most HMOs, like most hospitals and the Blue Cross organizations, began as non-profit services. State statutes initially prohibited HMOs from being profit-making businesses, and the federal HMO Act of 1973 provided grants only to nonprofit HMOs. Little known to the general public, the HMOs, by the mid-1980s, had obtained laws in every state except Minnesota to allow HMOs to be run for profit and in some cases to allow non-profits to convert to for-profit businesses.

CEOs of these health organizations find conversion attractive for the same reason CEOs of industrial corporations become involved with mergers, acquisitions, and leveraged buyouts. How they gain windfall profits is illustrated by the conversion of non-profit HealthNet to profit-seeking Health Systems International (HSI) in 1992. In that conversion, Roger Greaves, former co-CEO and co-chairman, paid only $300,000 for shares that were worth $31 million in 1996, a 10,000% gain. In fact, the shares representing 20% of the company purchased by 33 executives for $1.5 million were valued at about $315 million in April 1996.

Top executives' salaries also escalate. In 1994 HSI's CEO was paid $8.8 million and Foundation Health's chief $13.7 million, compared with a salary of $803,000 for the chairman of Kaiser Permanente, non-profit and one of the nation's largest HMOs.

Typically the non-profit organization is undervalued by its executives and the regulatory agencies, the executives buy stock in the new company at low prices, and the executives become millionaires when the company's stock trades at its actual market value. Most valuations have not used competitive bidding to determine the fair market value of the company.[39]

Once the HMOs became profit centers, they entered the merger and acquisition market. In 1993, there were acquisitions of five large publicly-traded HMOs for $685 million. In 1994, there were 13 major acquisitions worth $4 billion. In 1995, United Healthcare purchased MetraHealth (a joint venture of Metropolitan Life and the Travelers Insurance Company) for $1.65 billion. In May 1996 Aetna Life and Casualty said that it would pay $8.9 billion to acquire US Healthcare, one of the fastest growing HMOs.

These health care empires apparently generate great profits for their management and stockholders, but whether they are good for the public is much in doubt. There is a strong motivation to cut costs by reducing treatment below what an independent physician would prescribe. The best known example has been rushing mothers and their newborns out of hospitals within 24 hours, a scandal that has brought about government action at state and federal levels, but many other cases have been aired of doctors being pressured to give less care or lower quality care than their own judgment would dictate—and to withhold information from their patients about treatment options not favored by the insurance companies or HMOs.

Loss of professionalism

The independence cherished by professionals is endangered by mergers and corporate medicine. Doctors, for many years, resisted incorporation as undermining their independence and personal relationship with patients. They reluctantly formed professional associations (PA) and professional corporations (PC) to avail themselves of the income tax advantages given to corporations over individuals and partnerships.

Their reluctance turned out to be justified, as further steps led to corporate medicine where medical decisions are increasingly dictated by administrators of insurance companies, hospitals, and HMOs. It is similar to the top-heavy load of administrators and "coordinators" in the schools, and the paperwork they create, that make it difficult for teachers to utilize their professional judgment in the classroom.

Doctors have also come under pressure from pharmaceutical companies (who provided much of the money that killed the Clinton health plan, also opposed by the doctors' organization). Mergers among hospitals, insurance companies, physician groups, and pharmaceutical companies create huge entities battling each other for control over patient care.

By mid-1996 big pharmaceutical companies had bought three of the five largest pharmacy benefit management companies (PBMs). These private bureaucracies that manage drug benefits for insurance plans maintain "formularies," lists of approved prescription drugs in which price is an important factor. Insurance companies use severe financial disincentives to induce patients to use listed drugs. Senator David Prior (D.-Ark) has suggested the PBMs may be favoring drugs of their parent corporations by switching patients from one drug to another without explicit regard to health.

Patrick Bond described the result this way: "Nearly two years after the demise of the Clinton health-care plan, nearly all of the plan's right wing critics' prognostications are coming true—but under the exact opposite circumstances they imagined. Patients are indeed finding their freedom of choice severely limited, but by emerging private oligopolies, not by a national health plan. Huge bureaucracies are making critical health-care decisions for patients, but those bureaucracies are private, not governmental. Waste is in fact widespread but it is private, not public, red tape that is the cause."[40]

The quasi-private U.S. Postal System

Years ago when it was widely felt that inefficiency in the government-operated U.S. Post Office was causing burdensome deficits, the operation was spun off into a quasi-private entity. It remained a monopoly and was under broad government supervision. Despite United States Postal Service (USPS) claims to the contrary, mail deliveries have become slower, stamp prices have continued to rise, and the proportion of commercial and fund-raising mass mail at reduced rates has risen sharply in contrast to first class letters used by the general public.

In the same kind of "revolving door" that has developed in the defense sector and various regulatory agencies, postal officials move to jobs with private sector mail sorting corporations while the postal Board of Governors is exclusively made up of corporate executives and compliant politicians. In 1988 a team of private mailing industry executives, publishers, and high volume mailers met with postal officials to restructure rates without any representation of the general public. Industry is now allowed a discount for pre-sorted mail that is nearly 20 times what it would cost the USPS to do the sorting on its own automated equipment. Most of the more than 80,000 workers in the pre-sort industry get minimum wage and have few, if any, benefits.

Postal jobs, once highly prized by large numbers of applicants who competed in civil service examinations, have become so stressful that some workers have snapped and their shooting rampages have created the expression "going postal" as a synonym for going berserk. Beyond this, the quasi-private USPS has contracted out parts of its work to private companies such as Time, Inc., R.R. Donnelly, ITT, and Lockheed. The private sector operations reap the benefits of the millions of dollars spent by the USPS on research and development of new mail sorting technologies, including optical character reading and remote sorting.

Fifteen new contracts for remote sorting were awarded in 1993. Communities and states entered into a bidding war with low wage rates, tax incentives, and outright grants to attract these contracting firms who claimed to be bringing "new" jobs to

communities. Actually, the contractors replaced postal workers who had operated letter sorting machines.[41] Pennsylvania offered nearly $3.9 million to DynCorp, whose workers at York earn $6.12 per hour. Oakland, California used at least six state and city agencies to help Envisions convert $13 per hour postal jobs to $8 per hour private jobs. Sarah Ryan commented in her 1995 article in *Dollars and Sense*, "Privatization turned out to require lots of public resources."[42]

Privatizing Social Security

Another target for privatization is Social Security. Proponents of radical changes in the system have sounded alarms, predicting that the retirement of the Baby Boom generation will deplete reserves faster than the workers of the smaller succeeding generation can replenish them. Critics keep referring to the government bonds in the trust funds as "mere IOUs"—a term they never apply to bonds held by individuals, banks, and foreigners.

Rump "Generation X" organizations have been widely quoted in the media as believing Social Security will be bankrupt before their turn for pensions will arrive. This propaganda war has the objective of commercializing Social Security so as to generate profitable commissions for stockbrokers. Several business-financed think tanks have been behind this effort.

The Advisory Council on Social Security issued a split opinion in 1997 that offered three different solutions, varying chiefly in the extent to which Social Security contributions would be diverted from government bonds to the stock market. There were 6 out of 13 votes for a plan to allow some assets to be invested in the stock market, but retain Social Security as one system. The other 7 votes were split between two plans that would divert some FICA contributions to new forms of Individual Retirement Accounts.[43]

Described by Kevin Phillips as the "eminence grise" of the investment industry's propaganda network, Peter G. Peterson, Chairman of the Blackstone Group of investment bankers, attacks Social Security in his capacity as president of the Concord Coalition.[44] Peterson was commerce secretary to Nixon, an

investment banker since then, and an advocate of a national sales tax. The Concord Coalition, sponsored by former Senator Warren Rudman and the late Senator Paul Tsongas, has proposed a ceiling on taxes for big business and the wealthy but cuts in Social Security and Medicare with means-testing and/or privatization of Social Security.[45]

Co-chairman of the Cato Institute's "Project on Social Security Privatization," begun in 1995, are José Pinera, the former labor minister of Chile who privatized that country's pension system, and William Shipman of State Street Global Advisors, an investment company.[46] By January 1977 the Cato Institute had taken its privatization campaign to the state level and legislatures of Colorado, Delaware, Georgia, and Oregon passed resolutions urging Congress to allow states to drop out of the Social Security system and set up their own plans for privatized pensions. This is part of the campaign in which the American Legislative Exchange Council (ALEC), a large coalition including prominent state legislators, passed a resolution as model legislation for state governments calling on the federal government to allow all states to opt out of the Social Security system.

Since advocates of privatizing Social Security have offered Chile as a model, it is worthwhile to look at that country's experience with privatization.

Pension privatization failure in Chile

The economic measures introduced in Chile by economist Milton Friedman and his disciples from the University of Chicago under the dictator, Gen. Augusto Pinochet, in the mid-1970s have been acclaimed by some as an economic miracle. This is debatable, as will be discussed in a later chapter dealing with discredited classical economics dressed up as neo-classical or neo-liberal. At this point the focus is on privatization of Social Security.

Among other things, they privatized such government services as parks, prisons, utilities, schools, health care, and pensions. When Chile's state-administered health and pension programs were privatized, the companies got to set service charges and exclude all but the best clients. The armed forces, however, were kept in special state-run programs.[47]

For ordinary Chileans, the state-run pension system, which had been described as inefficient, was replaced in 1981 by a private system of compulsory private savings. By ignoring commissions, a 12.7% real annual return on investment was claimed for the period between 1982 and 1995. World Bank economist Hemant Shah, however, showed that commissions reduced an individual's average return to 7.4%, and even lower over other periods of time, further reduced by the cost of financial advice on choosing among options at retirement that can absorb as much as 3% to 5% of the accumulated savings.

By contrast, the U.S. system pays no commissions and administrative costs are in the range of 1% to 2%. Many Chileans, moreover, are not covered in the system because of lax enforcement of the compulsory savings.[48]

Pension privatization failure in Britain

The British government, in the late 1980s, allowed workers to put part of their pension contributions into personal pension accounts while still paying into a government basic plan that provides about $100 a week minimum pension. Encouraged by a government media campaign and private financial promotions, millions chose the partial privatization, and millions suffered heavy losses. Investment firms owe about $18 billion compensation to victims of their bad advice and are under investigation by Scotland Yard.

Britain's Pension Investment Authority has estimated that a bail-out of investors' losses would cost more than $15 billion. According to recent testimony of Prof. Teresa Ghilarducci of Notre Dame University to the House Ways and Means Committee, the privatized system has saved only about $5 billion in government pension costs. Workers have to pay commissions and fees for management of their accounts that run about 20%, creating large profits for financial firms. She added that the few investment and pension companies that control 80% of the business averaged profits of more than 22% in 1995. She said the

reform recommended in the 1997 report of the U.K. Office of Fair Trading "looks a lot like our current U.S. Social Security System."[49]

What went wrong in the Soviet Union

The fall of Soviet communism in 1991 was acclaimed in the Pentagon as a victory for American military strength and in the business world as a long-awaited proof of the superiority of capitalism. Russians were to enjoy the blessings of democracy and free enterprise.

Disillusionment soon set in. Communism was out of fashion, but the Communist hierarchy declared themselves *ex*-Communists and continued to dominate the legislative process. Some early talk about the employees of state-run enterprises becoming the new owners faded away as the Communist bureaucrats who had controlled the economy in the old regime arranged to sell the government-owned factories to themselves at bargain prices.

Despite notable progress on the political front where open expression of opposing views was allowed and elections were contested instead of limited to a one-party slate, the economic changes were disappointing. The main winners were the old Communists, now dressed in capitalist clothing, and the business opportunists with few scruples who were able to take advantage of unsettled conditions. Gangsters and drug lords infested the new capitalist economy.

As the government stopped subsidizing factories, some were privatized (often turned over to the same management that ran them under Communism), some were closed, workers experienced unemployment for the first time, and other workers (including military and civilian government personnel) received no pay for months at a time.

"A small band of quasi-financial institutions has been systematically taking control of the country," reported Paul Tooher, national/foreign editor of the *Providence Journal Bulletin*, in 1998, returning from a year-long media project in Russia, "gaining control of, and selling off, its natural resources, buying

up the media to wage war against its financial challengers and seize control of the main levers of government....

"A privileged few have become fabulously rich and are willing to do whatever it takes to retain and increase their wealth....National resources [such as] a nickel mine in the Urals, a third of the nation's oil refining capacity [and] an interest in the nation's telephone system have been sold off under questionable auction procedures to a select group of Russian financial interests."[50]

All this made some Russians nostalgic for the days of Communism—even under Stalin's repressive regime. In my view, the problem was that Russia, after the collapse of Communism, embraced the extremes of commercialism and capitalism without the protections of government regulation that have set limits on greed in the United States and other Western democracies.

19. SAVING AMERICA FROM GOVERNMENT HEALTH CARE

As the privatization movement rolled on, there was no need to privatize health insurance because, for most Americans, it was already in the hands of private insurers. Even the government's Medicare program was contracted out regionally for administration by insurance companies. Bucking the tide of privatization, but strongly supported by public opinion according to the polls, the Clinton administration undertook in 1993 to provide universal health care in the United States like the other large industrialized nations.

When health care reform perished in Congress in 1994, there was applause from many commentators and a huge sigh of relief from the insurance and drug companies. Political opponents, ever since, have bragged about rescuing America from a disastrous health care plan. Do you believe America is better off without a national health plan? My own feelings were affected by what I had seen in Great Britain during World War II and years later.

One of the first things that struck me while stationed in England as an American soldier waiting for D-Day was the poor condition of the teeth of so many people. Some of them said they just couldn't afford dental work. Returning on a visit after the war, when Britain had set up a national health system, I was impressed by the bright smiles I saw everywhere. Of course, other aspects of neglected health had been helped too.

When President Harry Truman proposed a national health plan for the U.S., the American Medical Association fought it, assessing physicians to build a large war chest to fight what they called by the scare label "British socialized medicine." I was shocked to see AMA literature in my doctor's office that contained propaganda I knew to be false, because people in England told me they were pleased with their health care, contrary to scare stories from the AMA. Doctors in the British national health service still made house calls.

The popularity of the system endured so that in the 1997 British general election all three major parties agreed they wanted to keep and strengthen their national health system. It should be noted that "the free practice of medicine" still exists in Britain; that is, people who can afford it are allowed to go to doctors privately, but medical care is available to all "free at the point of delivery."

Failure to appease opponents

President Clinton asked his wife, Hillary, to lead the effort for health care reform, which caused some to admire her and others to vilify both of them. The plan that eventually emerged was not along the lines of the single-payer systems adopted by Canada and European countries but one that attempted to remove objections in advance by letting insurance companies and employers continue to participate, while allowing the states local variation. In the end, the efforts to appease these groups were unavailing and resulted in a plan that was vulnerable to attack for being too complicated.

The President invited bipartisan cooperation, welcoming any bill that would meet the essential requirements, but even his fellow Democrats could not, or would not, agree on either his plan or any of their own, and Congress took no action. Republican promises to come up with their own bill in the next session were never redeemed.

The political muscle of doctors and the health care industry is revealed in a March 1998 Associated Press report of its joint project with the Center for Responsive Politics, the "first complete computerized study of lobbying disclosure reports." Topping the list of spenders for the first half of 1997 was the American Medical Association, $8,560,000, leading the Chamber of Commerce of the U. S. by more than $1.5 million, and also in the top twenty was the American Hospital Association, $3,390,000. A single pharmaceutical company, Pfizer, was sixth highest at $4,600,000. The AMA had more than two dozen staff lobbyists. These figures, of course, do not include campaign contributions and cover a period after the battle against the Clinton health plan had already been won.[51]

Ironically, although massive industry propaganda and political contributions killed health care reform, the threatened evils have come anyway. Americans had been told by "Harry and Louise" in the TV ads, and by other fronts for the insurance industry, that:

- We'd lose our cherished right to select our own doctor.
- The proposal would create an expensive bureaucracy.
- Decisions about our health care would be made others than doctors, and people couldn't get care they need.
- Seniors would lose some of their Medicare benefits.
- The plan would place a burden on employers.
- There was no crisis because the rise in health care costs had slowed down.

Even by 1996 the following assessment could be made:

- We were rapidly losing our medical choices. Independent medical practices were being bought up by medical corporations that talk about customers rather than patients. Family doctors were being replaced by impersonal "clinics." And there was a growth of health maintenance organizations (HMOs), where choice of doctors is narrowed.
- The expensive bureaucracy had arrived—not government but private. The number of health administrators in hospitals multiplied nearly 700% from 129,000 in 1968 to 1,000,000. They grew from 18% to 27% of the health care work force, while doctors and nurses declined from 51% to 43%, according to a study in the American Journal of Public Health. The administrative costs of insurance companies were eating up 20% of all our health care spending.[52,53]
- The private insurance company bureaucracy has tightened its grip on medical decisions.
- Seniors continued to have their Medicare benefits reduced as they were forced to pay more out of pocket for coinsurance and deductibles.
- Employers who provide medical coverage saw premiums rise rapidly, and many have been switching to HMOs which restrict choice of doctors. The trend also continues for

employers to fill more jobs on a "part-time" no-benefits basis.

- Health care costs resumed their rapid rise as soon as the reform proposals had been killed, and continued to outpace the consumer price index. A sharp rise in drug prices is evident to all who buy medication.
- Any family's health insurance was still in jeopardy whenever corporate downsizing forces a job change.

Subsequent half-measures to let job-changers retain (and pay unlimited premiums for) insurance, and a 1998 proposal by President Clinton to let people get into Medicare early by paying $300 to $400 per month, run into the difficulty that the unemployed seldom can find the money to pay such premiums.

As rising costs imperiled Medicare funding, the Congressmen who had helped kill health care reform proposed to make seniors pay more in deductibles, co-insurance, etc., as well as raise the starting age to 67, thus adding many more people to the rolls of the uninsured. If universal health care had been enacted, Medicare could have been gradually absorbed.

Of course, Congressmen and their families have health insurance and can get free VIP treatment at Walter Reed and Bethesda military hospitals. People on welfare and people in jail get free care, and hospital emergency rooms are swamped with routine cases whose expensive care is added to the bills of paying patients. Rising medical costs threaten budget crises for the federal and state governments, not to mention family budgets.

World champion of health care?

A favorite argument of opponents of reform was that the United States already had the best health care in the world, a claim that seemed somewhat spurious when David Rockefeller and Henry Kissinger used it to persuade President Carter that the Shah of Iran must be admitted to the U.S. for medical treatment (it didn't save his life, but resulted in the staff of the American embassy in Iran being held hostage for the balance of Carter's term of office). Although American medicine may be at the cutting edge for those who can afford expensive new treatments, innovations have also come from other nations, even the Soviet

Communists who pioneered the techniques that permit the reattachment of severed limbs.

If it were true that Americans in general receive the best medical treatment in the world, our average life expectancy should be greater than Japan and other nations. Economist Lester Thurow noted: "America is well down in the charts when it comes to every measure of health—life expectancy, morbidity, infant mortality."[52] The World Health Organization (WHO) reported February 14, 1997, that life expectancies for men were 72 years in the United States but over 75 in Greece, Switzerland, Sweden, Israel, Australia, and Japan. Women's life expectancies were 79 years in the U.S. but 82 in Australia, Canada, France, Japan, Spain, and Switzerland.[53]

Anthropology Professor Barry Bogin concluded from a 25-year special study that we may be able to "use the average of any group of people as a barometer of the health of their society." He noted that the average height of American men grew from 5'6" in 1850 (then the tallest in the world) to 5'8", while Dutch men zoomed from 5'4" (shortest in Europe) to 5'10" (now the tallest in the world). His explanation:

"The Dutch decided to provide public health benefits to all the public, including the poor. In the United States, meanwhile, improved health is enjoyed most by those who can afford it. The poor often lack adequate housing, sanitation, and health care. The difference in our two societies can be seen at birth: in 1990 only 4% of Dutch babies were born at low birth weight, compared with 7% in the United States...."[54]

Can the U.S. afford universal health care?

Another fallacy advanced by opponents was that America could not afford universal health care, even though all the other advanced nations have it. Opponents cited the cost of covering those who can't afford insurance, but taxpayers are already paying for the poor, criminals in jail, and politicians at all levels. They are also paying large amounts that are excluded or deducted from existing insurance payments.

Many of the "costs" of the proposed plan to cover presently uninsured people are not new costs but already being paid by the public via Medicaid and hospital "overhead" for non-paying patients. The use of expensive emergency room facilities by the poor for ordinary illnesses, for example, is one of the most wasteful aspects of the present system.

Universal coverage of health care would permit Medicaid, which pays for medical needs of the poor (not to be confused with Medicare financed by Social Security funds), to be abolished. People helped off welfare by replacing Medicaid with health coverage at work could be paying taxes and health insurance premiums.

For all these reasons, it is possible that true reform might result in no extra cost when all factors are considered. The highest estimate I saw of additional cost was $100 billion, and this included hypothetical indirect costs to others than the federal government. Congress, that couldn't agree on health care, did agree in quiet bipartisan cooperation to spend hundreds of billions of taxpayers' money for S&L bailouts.[55]

Neither the Clinton administration nor the lobbyists against the Clinton plan gave any serious consideration to the simpler, less costly system, the single-payer system which is used in virtually all the civilized countries that have had national health systems for many years, but which would have imperiled the profits of insurance companies. It was favored by some members of Congress and the American College of Surgeons, which said it would reduce bureaucracy more than any other health-reform proposal as well as preserve choice for patients and physicians.[56] The 1,500 insurance companies whose administrative costs eat up 20% of all our health care spending would, of course, label a single-payer system "socialism."

The public can take little comfort in the poetic justice inflicted on doctors by the insurance companies and HMOs after they helped kill universal health insurance. The doctors first, through the AMA, killed Truman's national health plan. They fought hard but unsuccessfully against Medicare, then learned to use it to their advantage. Finally, they teamed up with the

insurance companies and pharmaceutical industry to kill the 1994 proposals.

I can remember when doctors made house calls, family doctors could read an X-ray, hospitals never turned away a patient for financial reasons, and people entered the medical profession because they wanted to heal people. Of course, there are many doctors today whose primary motivation is service, and others who are at least partly motivated to relieve suffering, but the prospect of making big money enters into the choice of occupation too much today.

In the 1970s, when I worked in financial communications, I remember well that medical companies became hot issues in the stock market, such as chains of proprietary (profit-making) hospitals, nursing homes, medical labs, and, of course, drug companies. At the same time, doctors were becoming so much more prosperous that they came to head the lists of prospects for anyone selling luxury homes, yachts, and investments in commercial real estate and other tax shelters. Is it any wonder medical costs have risen faster than the consumer price index?

Private insurance and Medicare have benefited doctors (and the hospitals they control) more than the public. Instead of the old situation where much charity work was done by doctors and hospitals, they now collect from Medicare and/or private insurance and often bill middle-class patients extra, while being paid by Medicaid for treating the poor.

The total public and private spending on health care, having grown twice as fast as the CPI from the mid-1980s to the mid-1990s, reached 12% of GNP without universal coverage, exceeding other advanced nations that have single-payer national health systems. This suggests reform could be afforded better than inaction. The prospects for reform, however, are not good.

20. WHY UNEMPLOYMENT EXISTS

Is there something wrong with the economic measure that is most important to many people—the rate of unemployment? It would be reasonable for the public to think that the official rate counts all the jobless, but that doesn't happen to be true. As the public learned about "downsizing" in the 1980s and 1990s with many thousands of employees being laid off by each company affected, it became hard to understand why the official unemployment figures didn't show huge increases. The answer lies in the definition the government uses.

The narrowness of official figures is acknowledged by the U.S. Bureau of Labor Statistics (BLS) in its booklet, *How the Government Measures Unemployment*: "Unemployment statistics are intended to provide counts of unused, available [labor] resources. They are not measures of the number of persons who are suffering economic hardship."

The BLS gets its statistics from a random survey of 60,000 households. Anyone who says he or she is working, or has worked at all—even one day—during the month, is counted as employed. Someone who works part time but wants to work full time is counted as employed. To be counted as unemployed one must have reported looking for work during the past month. Otherwise, that person is not counted as unemployed but is considered out of the labor force. An economics textbook by Stephen L. Slavin in 1991 estimated that only about half of all unemployed Americans were collecting unemployment insurance benefits.[57]

Economist Lester Thurow of MIT explained it in an article published in the March-April 1996 issue of *The American Prospect*. He estimated there were 5 million to 6 million jobless people not meeting the tests of the official definition for unemployment and 4.5 million part-time workers who would like full-time work. Adding these to the 7.5 million to 8 million officially unemployed workers, he counted 17 million to 18.5

million Americans looking for more work, or a real unemployment rate of almost 14%.

Thurow also counted 18 million contingent workers accounting for another 14% of the workforce: 8.1 million in temporary jobs, 2 million working "on call," and 8.3 million "self-employed" with few clients but too much pride to admit being unemployed, most of them looking for more work and better jobs. In addition, he cited 5.8 million males 25 to 60 years of age (another 4% of the workforce) in the census statistics but not counted as either employed or unemployed, some being among the homeless. "In the aggregate," he wrote, "about one-third of the American workforce is potentially looking for more work than they now have."[58]

The Organization for Economic Cooperation and Development (OECD) has determined a "coverage rate" of the unemployed in the U.S. and Europe by comparing, in each country, the number of unemployed people who receive benefits to the total number unemployed. The 1994 OECD Jobs Study found the coverage rate to be 98% in France, 89% in Sweden, and 93% in Germany, while the U.S., at 34%, was in the neighborhood of Greece (30%) and Portugal (36%).

Another difference among countries has been pointed out by Harvard economist Richard Freeman. Many people in America are in jail instead of being unemployed in the labor force. With imprisonment in the U.S. running roughly ten times the European rate, the number of U.S. men incarcerated in 1993 was almost 2% of the total number of men in the labor market, and another 2% of the nation's full-time employment was made up of police, judges, prison guards, and related jobs for handling them at a cost of around $100 billion annually.[59]

The natural rate of unemployment or NAIRU

Often polls have shown that jobs are the main concern of the public. For example, the AP poll in mid-December 1995 found the public considered jobs and the economy (26%) to be the most important issue, followed by education (18%), and health care (16%). People are rightly suspicious of official

unemployment figures and puzzled by statements by some economists that 6% is "normal."

Anyone who thinks about it will realize that zero unemployment would be impractical. Most workers leaving one job, voluntarily or otherwise, will not immediately step into another one, unless they have lined it up ahead of time. The more specialized their skills and the more particular their requirements about location, work schedule, etc., the longer may be the time required to find employment opportunities that are a good match.

This searching time, and other frictions in the labor market, result in some percentage of unemployment that is irreducible without extreme measures that would result in inflation. This is sometimes called the "natural rate of unemployment," but there is no general agreement on what the percentage is. Later it became more fashionable to use the acronym "NAIRU" which stands for "nonaccelerating inflation rate of unemployment."

George P. Brockway commented in a 1985 book: "People today argue over whether full employment is reached with 6% or more unemployed. Seldom is the figure any longer set as low as 4% (which is what economists used to have in mind)."[60]

Eisner described this hypothetical rate as "pernicious." He said its devotees "may think that in our perfect market economy whatever is must be optimal and natural....But I will maintain that involuntary unemployment due to a lack of aggregate demand or purchasing power is a fundamental fact of our economy."

Unemployment fell in February 1998 to the 24-year low of 4.6%, after the FRB passed up several opportunities to raise interest rates and inflation remained low. Before 1998 the last extended period of low unemployment was from 1965 through 1969, when it ranged from 3.5% to 4.5%. The unemployment rate rose to 8.5% in 1975 after the Arab oil embargo and remained above 5% for the next twenty years, reaching peaks of 9.7% in 1982 and 7.4% in 1992, and dropping to 5.4% in 1996. Within those annual average rates, the month of December 1982 had the highest unemployment since 1940 at 10.8%.

The issue became controversial within the Clinton administration over the question of welfare reform, intended to prevent people from making welfare a permanent way of life. Labor Secretary Robert Reich recalled the dilemma in the White House over what to do with welfare recipients who still can't secure a real job after doing everything asked of them. The "bleeding-heart old liberals" would keep them on the welfare rolls, he wrote, while the "tough-love New Democrats" argued for a strict cut-off point.

Noting that most of the President's economic advisors would accept eight million unemployed "in order to soothe the bond market and prevent even a tiny increase in inflation" while his "tough-love" welfare advisors assumed jobs would be available for all welfare recipients, Reich declared: "If at least eight million people have to be unemployed and actively seeking work in order to keep inflation at bay, the additional four million on welfare simply won't get jobs."[61]

Unemployment and laziness

A president of the American Economic Association, Franco Modigliani, declared in his presidential address that the natural-rate-of-unemployment hypothesis implied the sharp drop in employment of depressions and recessions was due to "epidemics of contagious laziness."[62] This remark parodied the attitudes of those who treat a considerable amount of unemployment as normal and who cling to the idea that market equilibrium assures jobs to those who really want them.

The more secure one's job, the more likely one is to blame poverty on idleness. Such an attitude was characteristic of Victorian times and carried over into the 1930s. Republicans with jobs were bitter in their sneers at FDR, "That Man in the White House," and the men he put to work in the WPA. They were depicted by editors as leaf-raking and in cartoons as leaning on their shovels. Being poor was treated as a sin.

"Oddly enough," Robert C. Lieberman of Columbia University has observed, "all of this moral weakness vanished a decade later when the postwar boom produced an era of full employment. The indolent poor of the 1930s became the blue-

collar middle class of the 1940s and 1950s. Evidently, they were all-too-willing to work hard for decent wages. What was missing in the 1930s, it turned out, were not virtues but jobs."[63]

A classic example of misunderstanding the problem is Marie Antoinette's exclamation, "Let them eat cake!" when she was told the poor of Paris had no bread. The modern day counterpart is heard from many self-described conservatives who proclaim, "Let them work!" as a solution for mothers on welfare and people on Social Security. It has little relation to the real world, as most job applicants have learned from experience.

Jobs are supposed to appear miraculously according to Say's Law, a pillar of classical economics attributed to French economist Jean-Baptiste Say (1767-1832), sometimes stated as "supply creates its own demand." That is, the income generated from any level of production would finance demand equal to the supply resulting from the production. Therefore, a "universal glut"—that is, a depression—would be impossible. However plausible the theoretical logic of Say's Law, the worldwide depression of the 1930s proved it wrong in practice.

Some of the most sensible explanatory writings during that Great Depression were by Stuart Chase of the Twentieth Century Fund. In his book, *The Economy of Abundance* (1934), he wrote that his title referred to "a condition never obtaining anywhere until within the last few years" which he felt occurred about 1900 and defined as "an economic condition where an abundance of material goods can be produced for the entire population of a given community."[64]

Chase asked, rhetorically, "Why cannot markets expand, and so keep capitalism afloat indefinitely?" His answer was that capitalism supplies goods "only if enough money is forthcoming...to cover all costs of production including interest, plus a margin of profit....The ten million unemployed in this country today [January, 1934] would gladly take a volume of goods which would make factory wheels hum. The factory wheels are silent because the unemployed have no money."

Chase went on to observe that production could keep on rolling if somehow people could be provided with cash, but that is inflation ("more feared—see almost any editorial in 1933—than

loss of markets") if people are equipped with money outside the rules of the game. The gist of his ten "rules of the game" is that private bankers control the supply of money, manufacturing it by issuing business loans and crediting checking accounts.

"Private bankers cry to high heaven," Chase observed, "when the government proposes to create some money of its own against, let us say, public works. Why is this more reprehensible than creating money against a shoddily built apartment house which may never be rented?" In the rules of the game, the bulk of "unearned income" is not spent but reinvested, which naturally requires finding something profitable to invest in. To produce consumer goods, investment must first be made in capital goods. If the capital goods sector has developed its plants and processes to a point where no further profitable opportunities are offered, savings will not flow into it. "Capitalism officially ends when the flywheel—the production of capital goods—ceases permanently to turn over at its accustomed compound interest rate."[65]

The Keynesian revolution

Despite Stuart Chase and some others, the idea that government could do anything about unemployment (and business cycles in general) did not catch on until the publication of a landmark book, *The General Theory of Employment, Interest, and Money,* by British economist John Maynard Keynes in 1936. Before that the prevailing belief was that the cycles of boom and bust were inevitable, and that anything government might do would be harmful rather than helpful to the necessary adjustment of the economy.

Conventional wisdom held that business cycles must run their course, but Keynesian policies inspired governments around the world to work for full employment. The first sentence in Keynes' final chapter stated: "The outstanding faults of the economic society in which we live are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes."[66]

Keynes founded economic principles that have been credited with making the Great Depression of the 1930s the last. Keynes' approach called first for stimulating a slow economy by

government outlays and tax reductions that would cause a deficit, and second for offsetting that deficit by reduced outlays and/or higher taxes during a boom to pay off debt and restrain inflation. The application of these methods is called "fiscal policy." Keynes' answer to monetarists, who prefer "monetary policy" and claim the economy can be stimulated by reducing interest rates, was that their method was like trying to push a rope.

In the U.S. some steps were taken by government to combat the depression even before publication of the Keynes masterpiece in 1936. Unlike President Herbert Hoover, who said "prosperity is just around the corner" and waited for the economy to heal itself under classical theory, President Franklin D. Roosevelt took bold actions.

Although the Supreme Court thwarted various of his attempts by ruling them unconstitutional, FDR maneuvered to put many of the unemployed back to work. His policies resulted in building thousands of schools, libraries, hospitals, post offices, public housing units, etc., electrification of farms, highway construction, improvement of public lands, and production of artistic, historical, and literary works, all through government programs that enabled millions of men and women to do useful work.

"The extent of these contributions is obscured," wrote George P. Brockway (1985), "by the statistical quirk whereby those who worked for the WPA, CCC, NYA, and the rest of the so-called alphabet soup are evidently counted as unemployed." He added that the cost of the program was not substantially greater than the cost of inaction. "The budget deficit in 1932, the last Hoover year, was $2.7 billion, while in 1940, the last pre-war year, it was $3.1 billion."

Brockway quoted Keynes, "Pyramid-building, earthquakes, even wars may serve to increase wealth, if the education of our statesmen on the principles of classical economics stands in the way of anything better....It would, indeed, be more sensible to build homes and the like."[67] After FDR, other administrations used Keynesian fiscal policies to stimulate production and employment, somewhat enthusiastically under Democratic

presidents and congresses and more reluctantly under Republicans.

Carter's bad luck

The last such effort on a major scale was in the administration of Jimmy Carter, who recalled in his memoirs: "Joblessness was our most pressing economic problem. More than eight million Americans were unemployed and the creation of jobs was a top priority for me....By the end of four years about 10 million new full-time jobs had been created, less than 10% of which involved employment in government....Although the budget costs of these [job training and public service] programs were substantial, the *net* cost...was quite small because people who worked stopped receiving welfare and unemployment-compensation payments."[68]

Despite the job creation cited by Carter, which brought the official unemployment rate down from 7.7% under Ford in 1976 to 5.8% in 1979, the rate was up again to 7.1% in 1980, the year Carter lost his reelection bid and was replaced by Reagan. Carter's defeat was partly due to the hostage crisis in Iran and the failure of either the military rescue mission or negotiation to secure their release, but that was not all. It was his further bad luck that OPEC, which had caused worldwide inflation and recession by quadrupling the price of oil in 1973, sent another shock in 1979 for a repeat performance that caused rapid inflation (up 11.3% in 1979 and 13.5% in 1980). The monetarists blamed the inflation not on OPEC but on Keynesian economics.

This was the last time Keynesian fiscal policy was used consciously to stimulate the economy, although the deficit spending of the 1980s, largely for the Cold War, had an expansionary effect, while political rhetoric was claiming reduced spending.

21. DOWNSIZING AND DOWNGRADING

Not only do official statistics present too rosy a picture of unemployment, but also other recent problems have been underplayed. Workers' problems since the mid-1970s have included deterioration in working conditions, especially longer hours, lower wages, and loss of fringe benefits, while jobs have become more insecure. At the same time labor unions have declined in membership and have been forced to make unusual concessions to employers. Attacks on the unions were aided by the Taft-Hartley Act of 1947, taking away some of the power given to labor unions by Roosevelt's National Labor Relations Act. Waves of strikes that seriously inconvenienced the general public, as well as the penetration of some unions by mob racketeers, had built up sentiment against the unions.

Such strength as the union movement had in 1981, when Reagan took office, was seriously undermined by his treatment of the air controllers and their union when they struck over work pressures they considered a threat to air safety. He fired them all and banned them forever from working for any agency of the federal government. That was an example, of course, that private employers were happy to follow, and it was an action that intimidated labor unions, especially those whose members were government employees.

Economist Lester Thurow declared: "President Reagan's firing of all of America's unionized air traffic controllers legitimized a deliberate strategy of de-unionization. In the private sector, consultants were hired who specialized in getting rid of unions, decertification elections were forced, and legal requirements to respect union rights were simply ignored—firms simply paid the small fines that labor law violations brought and continued to violate the law. The strategy succeeded in shrinking union membership to slightly more than 10% of the private workforce (15% of the total workforce)."[69]

The memoirs of Secretary of Labor Robert Reich contain this note, dated Feb. 13, 1993: "The AFL-CIO is dying a quiet

death and has been doing so for years. In the 1950s, about 35% of American workers in the private sector belonged to a union. Now membership is down to about 11%, and every year the percentage drops a bit further....”[70]

Unions have continued to weaken, seldom getting support from the National Labor Relations Board (NLRB), and facing employers’ threats to close plants unless workers accept their demands for lower pay, longer hours, etc. These threats were not empty. Many companies moved their production to low-wage, non-union plants overseas, sometimes with the help of federal subsidies. Labor unions can no longer be considered a powerful force in national life.

Strange disappearance of the affluent society

Anyone who is old enough can remember a popular topic of discussion in the 1960s and 1970s was the affluent society, and the national problem of how people could make good use of their newly found leisure time. A few years later that idea took on a bizarre ring, as Americans found they were working longer hours for less pay than many Europeans.

John Kenneth Galbraith gave the title, *The Affluent Society*, to his 1958 book, since revised and reissued several times. The beginning of the 20th century having been picked by Stuart Chase in 1934 as the time when it became possible to produce enough material goods for all, Galbraith saw the “affluent society” as the next step, where maximizing production was no longer the major goal. “In a society of high and increasing affluence,” he wrote, “individuals...will work fewer hours or days in the week. Or they will work less hard. Or...it may be that fewer people will work all the time.”

He pointed out that the small, idle leisure class of earlier times had been replaced by a much larger “New Class” consisting of workers such as business executives and scientists who would be insulted by the suggestion that their principal motivation in life is pay received. “No aristocrat ever contemplated the loss of feudal privileges with more sorrow than a member of this class would regard his descent into ordinary labor where the reward was only the pay,” he wrote.

He remarked on the growth of the New Class in the U.S. from not more than a few thousand individuals in the 1850s to millions whose primary identification is with their job rather than the income it returns. Since the last century, he noted, the average work week declined from an estimate of nearly 70 hours in 1850 to a 40 hour normal work week a century and a quarter later.[71]

The trend celebrated by Galbraith has been reversed in the final quarter of the 20th century. Instead of working fewer hours or days in the week or less hard, as he predicted, some people are working overtime, some are working several jobs, and some are working temporary and part-time jobs without benefits because they have to, while others who want to work are denied the opportunity, often with the cruel excuse, "You are overqualified."

Ironically, these harmful results have been accelerated by U.S. policies: tax laws have rewarded corporations for moving operations outside the country, foreign aid has encouraged other countries to compete with U.S. industries, and international agencies such as the World Bank and the International Monetary Fund (IMF) to which the U.S. contributes have offered financial incentives for less developed countries to shift from self-sufficient farming and local industries toward factory production for export.

American corporations have also shortsightedly contributed to U.S. economic decline by selling or revealing advanced technology to foreign competitors. In three years 1986-88 alone U.S. companies sold roughly $5.6 billion of technology to Japanese corporations. During the 1980s U.S. corporations sold more than $225 billion of their technology to foreign competitors.

A 1990 book by Florida and Kenney stated: "A recent survey of leading electronics corporations by Ernst & Young [reported] 72% of companies with revenues in excess of $300 million and...61%... between $100 and $300 million have manufacturing plants located offshore....This reality remains hidden from many Americans, because so many of the final products bear American names....But...most of the jobs and manufacturing wealth is created outside the US....

"We have fallen so far off the cutting edge of semiconductor facility construction that an increasing share of new American semiconductor fabrication plants, including IBM's

new advanced chip facility in East Fishkill, are being built by Japanese companies...." The authors quoted James Koford of LSI Logic: "...We sell our innovations and get a one-shot infusion of capital, not a continuous product stream...."

The use of foreign contractors, in addition to outright sales of technology, also aids foreign competition. Subcontractors learn from blueprints, product specifications, machinery, and even engineers supplied by the American firms for setup and quality control. Florida and Kenny declare that "U.S. high-technology firms...are now being forced to establish manufacturing partnerships with Japanese corporations to gain access to state-of-the-art Japanese production technology and management techniques...."

In 1988 the top three companies obtaining U.S. patents were all Japanese. The only American companies in the top 10 were General Electric and IBM.[72] Haynes Johnson (1991) quoted an explanation by Howard I. Podell, a registered patent agent and successful inventor from Tucson, Arizona: "Companies these days are run by business school graduates who are profit-oriented, not product-oriented....U.S. inventors have had to go abroad [as he had done] to patent their products."[73]

Lack of unions lures industry

As companies seek to cut costs, they use plant moves or the threat of such moves to thwart labor union efforts for higher wages or better conditions. A prime motive for owners to move most of the New England textile plants to Southern states was avoidance of unions. The same motive is involved in moving many of those same plants outside the U.S. to countries where governments and the police are unfriendly to unions.

High-technology workers now face the same threat. When Atari's California plant with some 2,500 workers was on the verge of unionization, the company moved its production to Taiwan and Hong Kong. Although a National Labor Relations Board suit eventually brought an out-of-court settlement, the plant and the jobs were gone. This story has occurred over and over again in various industries.[74]

Breaking the unions helps corporations become more competitive on the global scene. So does escaping from health, safety, and environmental regulation. World business leaders, in a March 1996 survey, rated the U.S. economy as the most competitive among industrialized nations, immediately followed by Singapore and Japan. Other countries in the top ten include Malaysia and Hong Kong.

When business leaders say "most competitive" they mean low wages, few worker benefits, and deregulation. Manufacturing labor costs per hour in 1994 averaged $17.10 in the U.S., $27.31 in Germany, and $21.42 in Japan, according to the Bureau of Labor Statistics. Americans put in more working hours during an average year (1,847) than workers in Britain (1,622 hours), France (1,619), Sweden (1,569) and Germany (1,419). In no country other than the U.S. do CEOs of corporations make 150 times the income of workers on the shop floor.[75]

22. OLD THEORIES IN NEW CLOTHING

Monetarists and neoclassical economists delightedly (and prematurely) declared the end of Keynesianism when economists of the dominant Keynesian school found it hard to explain the simultaneous combination of inflation and unemployment in the late 1970s. According to a theory developed by British economist A. W. Phillips, the rates of unemployment and of inflation were supposed to move in opposite directions, and the data for the years of the 1960s could be fitted very neatly to a curve (the Phillips curve) showing this inverse relationship. When this broke down in the 1970s, the unhappy combination of unemployment and inflation was dubbed “stagflation.”

Keynesian principles, which had prevailed for about 50 years, had rescued the world from the boom-and-bust business cycles that peaked in the 1929 stock market crash and the 1930s Great Depression. With the arrival of “stagflation” in the 1970s, rival economic theories emerged. The news media reported these ideas as new, seldom acknowledging the fact that they were merely retreads of the disproven theories from the era of Presidents Harding, Coolidge, and Hoover.

The election of President Ronald Reagan in 1980 provided a splendid opportunity for the anti-Keynesian economists. Chief among them was Milton Friedman of the University of Chicago, where a large body of professors and their graduate students exerted an enormous influence on other economists and government officials around the world. This movement was not wholly a spontaneous scholarly effort. Financial support from business interests to universities and research foundations encouraged studies justifying corporate freedom versus government action.

In his 1997 book, *Everything for Sale*, Kuttner discussed why “press accounts of economic issues repeat, mindlessly, truisms about the superiority of laissez-faire”—the classical Chicago School doctrine. “Much of the responsibility,” he opined, “rests with the economics profession. Even among the most

heterodox economists, especially those wishing to retain their standing in the neoclassical church, there remains an almost intuitive reverence for markets and a skepticism of state intervention."

Discussing extensions of the neoclassical market model to legal and political procedures (in the Law and Economics movement and the Public Choice doctrine), Kuttner wondered why theories "so extreme and tautological" were taken seriously in the academic world. He concluded that perhaps most importantly they "are very reinforcing of the laissez-faire ideal and thus very congenial to society's most powerful," noting that "conservative foundations have spent tens of millions of dollars subsidizing research by sympathetic academicians with the premise that their work will help propagate this faith."[76]

Such foundations were joined by corporations in underwriting all-expenses-paid institutes and seminars at resort locations where some 600 federal judges have been exposed to the Law and Economics arguments, possibly violating the Judicial Code of Conduct prohibition of judges accepting gifts. They were encouraged to favor common law over enacted laws and administrative regulations. Later, the movement reversed position to support legislative limits on damages awarded in courts. Conservative foundations have also spent millions of dollars, according to Kuttner, endowing chairs to propagate these views, "and law schools, bending the usual rules that appointment decisions are not influenced by benefactors, have gratefully accepted the money."[77]

Friedman's theories seduced Margaret Thatcher in the U.K. and then Ronald Reagan in the U.S. The "new" Reaganomics was really a revival of old pre-Keynesian theories. In the 1980 Republican primary campaign, George Bush denounced Reagan's proposals as "voodoo economics." When offered the vice-presidential spot on the Reagan ticket, his attitude changed and thereafter he praised what he had first condemned.

The reactionary economic movement disguised the old discredited classical economics as new with such terms as "neoclassical," "monetarist," and "supply-side." An innovation to some degree was the "rational expectations" theory, which was

sound in predicting that investors would act on their beliefs about what government would do in fiscal and monetary policies, but went too far in claiming this made it useless for the government to do anything about the economy.

Vindication of Keynes

The flaws that Keynes had found in classical economic theory did not magically disappear, nor did his principles fail to operate in the 1980s, when monetarists declared Keynesian economics obsolete. Volcker and the FRB continued to tightened the screws and brought down the rate of inflation by 1982, but unemployment was at its worst since 1940 and inflation-adjusted GNP actually declined. This was monetarist policy, of course, but Keynesians never doubted that tight money could stall the economy. They just didn't believe that relaxing it would jump-start the economy.

The recovery that began from the depths of 1982, proudly hailed by Republicans as the longest-lasting recovery in history until then, was fueled by government spending (and purportedly by tax reduction) in accordance with Keynesian fiscal policy. The increases in military spending greatly offset the trumpeted reductions in social spending.

Even the Phillips curve took on new life. When the unemployment and inflation rates for 1985-96 are plotted on a Phillips graph, they follow the shape of the expected inverse curve fairly well. The significance of this pattern might be suspect, given the incompleteness of the official unemployment rate, but if that rate tends to vary during the period measured in line with changes in the total jobless rate, it could serve as a rough proxy for the latter. The stagflation phenomenon, in retrospect, seems limited to the years immediately following the OPEC shocks of 1973 and 1979.

Wherever the "new" economic theories from the past were tried, as in Britain, America, and Chile, the rich became richer at the expense of everyone else, unemployment spread, and government debt skyrocketed. Yet the proponents continued to argue that everyone benefits from reducing upper-bracket taxes and deregulating corporations.

The economic miracle in Chile

American business magazines and news services were ecstatic in praising what they called "Chile's economic miracle" under the guidance of Milton Friedman and his associates from the University of Chicago for about 15 years until 1990, when the military dictatorship was replaced by Patricio Aylwin, the first democratically elected president in 17 years.

There had been a coup in 1973 in which the Chilean military, with the help of ITT and the CIA, overthrew the democratically elected government of President Salvador Allende Gossens, a socialist, assassinating him and thousands of his followers. After nearly two years, Friedman's disciples succeeded in selling the military regime on their doctrine and received extraordinary powers to impose their will on Chile's economy.

Under military dictator General Augusto Pinochet, the "Chicago Boys" produced impressive macro-economic statistics at horrendous human and environmental cost, according to a 1995 book by Joseph Collins and John Lear. By 1990, Chile had relatively low inflation, strong economic growth, high levels of foreign investment, and an export boom, all of which had been extravagantly acclaimed in the press. As good as these results sound, however, Chile's "miracles" are actually recoveries from severe recessions in 1975 and 1982.

The Chicago "reforms" included deregulation of industry, tariff reduction, and clearing the way for foreign investment. They also auctioned off government-owned enterprises at a fraction of their value, ended price control of basic necessities, and privatized many important government services. More accurately described as disaster than miracle was the rise in poverty from 20% to 41% between 1970 and 1990, inadequate housing from 27% to 40% 1972-1988, and foreign debt from $5 billion to $21 billion, one of the world's highest per capita.

Contradicting their own free-market principles, the "Chicago boys" and Pinochet socialized $16 billion in bad debt, most of it borrowed by private industry, and kept the armed forces in government health and pension programs while civilians were left to the mercy of private providers. They also balanced the

budget by selling off government assets to multinationals and to relatives and cronies of the Pinochet regime at about half their value. Corporations bought outstanding Chilean loans for 30% of their face value from international banks and were able to apply 100% to the purchase of the state enterprises.

The telephone and utility monopolies were sold free of any regulation, and electricity and telephone rates outstripped inflation by 45% and 64% respectively between 1981 and 1985. Pinochet sold off government saw mill operations and permitted export of low-value raw logs and wood chips. Private conglomerates were allowed to devastate extensive reforestation projects of Monterey pine that the pre-Pinochet Chilean government had been growing for 16 to 20 years.

Even in the best years of the new policies, unemployment was 18%. The Labor Code of 1979 strengthened rights of employers against workers. In the 1982 recession some employers declared bankruptcy, laid off senior workers, and rehired them at entry-level wages, while many employers stopped contributing to pension and health programs after they were privatized.

The 1980s increased the share of national income of the top 10% of Chileans from 37% to 47%, and reduced that of the middle class from 23% to 18%. Collins and Lear declared: “The Chicago Boys’ policies were a declaration of total class war that only appear to be a miracle to the ruling elite or to the ignorant.”[78]

Part Four: The Awesome Power Of Bankers

23. THE UNELECTED RULERS OF THE U.S. ECONOMY

There is an almost religious belief expressed in many editorials that the independence of the Federal Reserve guarantees wise and objective decisions in economic policy matters. Some of us are inclined to challenge this view.

Although a staunch monetarist, Milton Friedman has nothing good to say about the historical efforts of the Federal Reserve to regulate the economy. In his 1983 book, he wrote: "From 1929 to 1933, far from preventing bank failures and bank collapse [it] actually produced them....The Federal Reserve System...allowed [runs on thousands of banks starting in December 1930] to develop and banks to fail...producing by far the worst and most disastrous panic in American history. From 1929 to 1933, the quantity of money in the United States fell by one-third."[1]

Agreeing with this judgment of counterproductive policy, the more progressive economist Lester Thurow noted: "In 1931 and 1932...economic advisors such as Secretary of the Treasury Andrew Mellon were arguing that nothing could be done without risking an outbreak of inflation—despite the fact that prices had fallen 23% from 1929 to 1932 and would fall another 4% in 1933...." Some sixty years later, the same mistake was being made, he observed: "By raising interest rates in 1994 the Fed killed a weak American recovery that had yet to include many Americans and slowed a recovery that was barely visible in the rest of the industrial world...."[2]

Unlike most industrialized countries, which have a central bank at the heart of their financial operations, the U.S. has created a pyramid of banks. Under the Federal Reserve Act of 1913 twelve regional Federal Reserve Banks, authorized to issue currency, were set up with capital supplied by member banks and placed under the control of the Federal Reserve Board (FRB),

which controls rediscount rates on loans made by the district banks.

The FRB Board of Governors is appointed to staggered 14-year terms, only one expiring every second year, which severely limits the power of any President to influence their decisions. Their control of the money supply gives them a veto over economic expansion and a means of bringing about recessions and depressions.

Central bank independence

Until recently other industrialized nations differed from the U.S. in that their elected governments controlled both monetary and fiscal policy. The FRB in America had, and continues to have, independent control of monetary policy, while fiscal policy, which involves expenditures and taxes, remains in the hands of Congress.

Shortly after the British Labour Party won a majority in Parliament in May 1997 and Tony Blair became Prime Minister, the Bank of England was given independent authority to set interest rates. Analyzing this move, Richard W. Stevenson in *The New York Times* noted a trend for nations to give increasing autonomy to their central banks.

"The Bundesbank in Germany is generally considered the most independent of all central banks," he wrote, noting that new legislation in Japan will provide more autonomy to the Bank of Japan, and similar steps have been taken in France, Chile, and New Zealand. The European Central Bank, planned to go into effect in 1999, will be free of any direct control by member nations and virtually independent of the political leaders who are to appoint the central bankers. Stevenson observed that "unlike the Bundesbank, which by law is focused solely on price stability," the Federal Reserve's mandate "extends to supporting full employment as well." He didn't comment on the FRB's amnesia concerning this duty, which it also has by law.

Bankers, of course, applaud this trend. Stanley Fisher of the International Monetary Fund (IMF) stated their point of view in an article: "Political systems tend to behave myopically, favoring inflationary policies with short-run benefits and

discounting excessively their long-run costs. An independent central bank, given responsibility for price stability, can overcome this inflationary bias."[3]

Objectivity of the FRB

The long staggered terms of the FRB members make them largely independent of the President and Congress. It is debatable whether they should be free of the obligation to answer to somebody. In any case, don't think they are non-political—after all they are bankers with the priorities and conservative leanings of their profession, and almost all bankers belong to the same party. With their power to clamp down on credit, they can either let the economy roll during an election year, favoring an incumbent president seeking reelection, or create a recession that virtually assures his defeat.

The FRB controls the money supply by making changes in the interest rates banks pay for funds borrowed from the regional Federal Reserve Banks or from other banks, and/or conducting "open market" operations which affect banks' lending abilities as the result of purchases or sales of government bonds. The first obstacle to objective and scientific control of the money supply is the lack of a truly satisfactory measure of the money supply, which is supposed to be the amount of cash and cash equivalents in circulation. This always includes checking account balances because they can be drawn on like cash.

Savings accounts or time deposits can require advance notice for withdrawal, although at most times this is waived by the banks, so the question arises whether such balances should be included in the money supply. As credit cards have come to be used in place of checks for many purposes, shouldn't they be considered cash equivalents? And what about mutual fund investments that can be converted to cash by a phone call? A variety of definitions has led to a handful of different money supply measurements, M1, M2, M3, etc.

Money supply vs. interest rate criteria

In October 1979, when Federal Reserve Chairman Paul Volcker returned from an international monetary conference

determined to pursue a tight monetary policy to restore confidence in the dollar, he declared that the FRB would focus on stabilizing the growth rate of the money supply rather than stabilizing interest rates. Brockway (1985) has pointed out that "if the money supply merely kept pace with the increase in GNP, M-1 would have reached $858 billion by 1983, instead of the $521 billion it did reach....It is because of scarcity that money can earn interest; and the more severe the scarcity, the higher the interest."[4]

Blinder (1987) inferred that Volcker used the monetarist doctrine about the money supply to shield him from the angry reaction he expected from Congress and the public if he admitted his campaign of disinflation would require excruciatingly high interest rates. Interest rates zoomed to a peak in 1981 (nearly 19% prime rate), a sharp rise in unemployment followed, and the policy was exposed as a disaster. The experience of 1981-83 contradicts the monetarist contention that the velocity of money (how frequently it changes hands through transactions) is essentially constant, Blinder pointed out, and velocity "fell between summer 1981 and spring 1983 at rates no one dreamed possible."

"According to monetarism," he added, "the way to slow inflation is to bring down money growth. But money growth actually *accelerated* during the critical period of declining inflation." While inflation dropped from 8.7% in 1981 to 5.2% in 1982 and 3.6% in 1983, the money supply growth rate rose from 5.2% to 8.7% and 10.4% in those same three years. "With velocity falling rapidly, these money growth rates were not sufficient to provide the economy with the liquidity it needed." The editorial page of *The Wall Street Journal* pronounced monetarism dead in December 1985, and early in 1987 Chairman Volcker told Congress that the FRB no longer had any targets for the growth rate of M1.[5]

FRB under Greenspan

Under the chairmanship of Alan Greenspan, appointed by Reagan and reappointed by Clinton, the FRB has watched for signs of economic growth and stifled it by raising interest rates and thereby restricting the availability of credit. Again in 1994 the

FRB proved it can slow down an economic recovery, and the stock market declined on its increase of interest rates.

Thurow pointed out in a 1996 article that little improvement is possible for the economy under FRB policies: "Suppose that productivity (the output per hour of work) rises by 2% a year, and that the labor force increases by 1% annually. To prevent layoffs of those no longer needed with improved productivity, and to employ the new workers, the GDP must grow by 3% a year. But the [FRB] limits economic growth to 2% in order to battle inflation [by] raising interest rates whenever growth reaches 2% or 2.5%."[6]

Previously the United States experienced a much higher rate of economic growth. "From the early-nineteenth-century introduction of steam power through the dawning of the age of the microchip in the post-World War II era," according to a 1997 article by Professors Bluestone and Harrison, "real economic growth in America averaged 3.8% per year."[7]

The austerity Greenspan recommends for others does not apply to himself, according to Reich's description of a luncheon meeting at Greenspan's private dining room on the top floor of the Federal Reserve Building in Washington: "The room is tastefully decorated—an antique clock, a Louis XIV sideboard, fresh cut flowers. The view of the Mall is spectacular. The table is set for two—linen tablecloth, heavy silverware, china plates and bowls, cloth napkins. This is the true center of power in the United States. Greenspan controls the Federal Reserve Board, the Board controls short-term interest rates, and short-term interest rates have a deciding influence on whether people have jobs...."[8]

Greenspan was paid a fee by the subsequently convicted Charles H. Keating, Jr., to write a letter in 1985 seeking a waiver from the Federal Home Loan Bank in San Francisco, in which he praised Keating's management (although Keating had signed an SEC consent decree in 1979 to a complaint that he arranged fraudulent loans) and described Lincoln as "a financially strong institution that presents no foreseeable risk to the Federal Savings and Loan Corporation." Keating's Lincoln Savings $2.6 billion failure was the most expensive of all the S&Ls.[9]

As Congress belatedly showed concern about megamergers of banks and other businesses in Senate Judiciary Committee hearings of June 1998, Greenspan again saw no risk, praising "the complexity and dynamism of modern free markets." He waved aside Senators' concerns about negative effects on employment, competition, and local credit availability.[10]

24. THE BUGABOO OF INFLATION

The subject of inflation has spawned a host of misconceptions, such as (1) that inflation hurts people of modest means, (2) that inflation always comes from wage increases, (3) that the Consumer Price Index (CPI) exaggerates inflation, and (4) that there is no inflation unless it shows up in the CPI.

During the Cold War the fear of Communism was closely followed by the fear of inflation, both whipped up by political speeches, editorials, and pronouncements of pundits. President Gerald Ford in 1974 declared that "inflation, our public enemy number one, will, unless whipped, destroy our country, our homes, our liberties, our property, and finally our national pride, as surely as any well-armed wartime enemy."[11] Blinder expressed astonishment: "Destroy our homes? Gee, I thought inflation destroyed my mortgage instead."[12]

President Reagan, British Prime Ministers Thatcher and Major, and Chilean dictator Pinochet all boasted of halting inflation, although in each case it was at the cost of sharp and painful spurts in the rate of unemployment. The same scenario has been followed in numerous countries around the globe under pressure from the World Bank and the IMF. Outstanding among the inflation fear-mongers in the U.S., of course, is the Chairman of the Federal Reserve Board. Sometimes market analysts explain a drop in the stock market after good economic news as due to fears of inflation. When they are more precise, they report that investors fear the FRB will raise interest rates to counter the inflation the FRB expects to result.

Typical of such events is one described in an AP news item published on March 25, 1997, just before a quarter-percentage-point interest rate hike that was followed by a sharp drop on Wall Street: "Even though inflation shows no signs of worsening, the Federal Reserve is apparently preparing to raise interest rates for the first time in two years.... The nation's inflation rate is actually lower so far this year: 2.3% for January and February compared with 3.3% for all of last year....In

congressional testimony last week, Greenspan stressed the 'importance of acting promptly—ideally preemptively—to keep inflation low.'"

Blinder (1987) pointed out that escalator clauses in contracts could provide insurance against inflation, but businesses and individuals rarely choose to use them. "The apparent reluctance to write indexed contracts suggests that people are willing to pay only small premiums against long-term inflation risks," he stated. "Yet society pays huge premiums for anti-inflation insurance when it keeps millions of people unemployed. Something seems amiss here."[13]

Eisner, in his 1994 book, *The Misunderstood Economy*, challenged the assumption that low inflation is good news, pointing out that for every buyer there must be a seller. He cited the many years when rapid increases in housing prices made it seem almost impossible to lose money in housing, resulting in housing and construction booms in many areas. Making it clear he was referring to moderate inflation, not continuously accelerating inflation, he observed: "Higher inflation has been associated with lower real interest rates, greater tax advantages, and hence more investment...more production, and more employment," except when caused by higher external costs such as huge oil price increases "accompanied by repressive government policies to combat it."

Noting that banks and savings and loan associations are hurt by rising interest rates as inflation grows, he questioned whether their self-interest should be allowed to dictate policies slowing the economy and creating substantial unemployment in a war against inflation.[14]

Groundless fear of inflation

How dangerous is inflation? Because prices and wages tend to rise and fall together, inflation is really immaterial to those who neither owe money nor have fixed investments. Debtors benefit by paying off loans in depreciated dollars, until they borrow again and have to pay higher interest rates. Inflation causes bonds to lose value (especially long-term bonds), but investors who have learned to diversify may offset this by gains in their

stock portfolios. Retirees are hurt by inflation if they depend only on annuities and/or bonds at fixed rates and if pensions are not adjusted for cost of living.

Inflation has been called the "cruelest tax," supposedly most harmful to the poor. However, the prices paid by the poor rise neither faster nor slower during inflation than the prices paid by others. The poor have been hurt when welfare payments failed to keep pace with inflation. The poor and middle-class working families suffered when inflation outran adjustments in income tax exemptions, but much more costly to them have been the joblessness and the difficulty of repaying debt resulting from the FRB's cure for inflation.

For people with investments, however, inflation means paying higher taxes on interest, dividends, and capital gains because the tax rates are not adjusted for inflation. As Blinder put it in 1987: "Inflation is indeed a cruel tax—but only if your income comes mostly from interest, dividends, and capital gains."[15] Before fretting too much about the wealthy, though, let's remember that their tax advisors have been rather effective in finding ways to minimize their taxes.

Is inflation really the worst thing that can happen to the economy? In the extreme, of course, runaway inflation can be disastrous, as in Germany in the 1920s and Brazil almost any time. The U.S., however, has often paid an exorbitant price in unemployment and lost production to avoid inflation (over one trillion dollars of GNP in 1982-86, by Blinder's estimate). The economists of the banking system, though, have long regarded inflation as a much greater threat than unemployment. Whenever employment improves, they go into a panic over fears of inflation.

Fear of inflation from wage increases

Among the statistics that worry the FRB the most are those that show improvement in average wages and/or reduction in the level of unemployment. Their reasoning is something like this: if the pool of unemployed labor declines, workers will fear less for their jobs and may successfully ask for wage increases, which their employers will pass on to their customers in higher prices, and that, of course, is inflation.

Economists recognize two theories of inflation: demand-pull (too much money chasing too few goods) and cost-push (wages, raw materials, and/or profits rising faster than production), and both could possibly be occurring at the same time.

The demand-pull theory only makes sense when the factors of production are fully utilized. It is characterized by shortages of goods and backlogs of orders. Since the 1970s the U.S. economy has been characterized by considerable excess capacity and numerous plant closings, while actual unemployment has greatly exceeded the official tally, so the theory doesn't seem to apply to this recent period.

The cost-push theory, on the other hand, explains the inflation of the 1970s that subsided in 1982. It wasn't, as some would say, due to powerful unions forcing wages up too much, nor was it due to sudden spurts in corporate profits. Clearly, the push came from a drastic rise in cost of raw materials, specifically petroleum. Since then, there has been none of the double-digit inflation that was so worrisome then, nor have workers been able to force wages up because labor unions have grown weaker and weaker.

Politicizing the CPI

It is strange that when he is not scaring Wall Street with inflation fears, FRB Chairman Alan Greenspan wears his Social Security expert's hat and tells Congress the Consumer Price Index, compiled by the Bureau of Labor Statistics, overstates inflation by as much as 1.5 percentage points. In 1997, with the CPI averaging only 2.8% over the previous four years this must have meant Greenspan thought the true rate of inflation was a mere 1.3%, so why did he and his FRB raise interest rates?

Politicians trying to cut social security, military pensions, etc., have welcomed his theory that the CPI exaggerates inflation, which he based on a study by two economists on his staff. Since the Federal Reserve recruits economists who reflect the attitudes of bankers, worrying a great deal about inflation and very little about unemployment, we should have considerable reservations about their economic conclusions.

Of course, the CPI is imperfect, as are other vital economic measures such as GNP, the balance of payments, and even the federal deficit, but for economic analysis we use them, lacking any better measures. They need to be calculated consistently by non-political experts, such as the BLS, which has calculated the CPI for half a century, not by Congress.

Looking for cover on a politically sensitive issue, Congress set up a commission in June 1995 to recommend changes in the CPI, but all the economists appointed had already said the CPI was too high. The panel announced its findings in mid-September without conducting any original research, and, to nobody's surprise, reached the same conclusion its members had previously expressed at congressional hearings. It was as if a jury were picked from people who had all previously declared themselves in favor of a guilty verdict. Economists who differed, some pointing out that elderly pensioners experience higher than average price increases in such areas as out-of-pocket medical expense, were excluded from the commission.

The usual arguments for the CPI overstatement position involve substitute goods, discount stores, quality improvements, and reduction of prices on new products. Their logic breaks down when these factors are closely examined. If consumers substitute cheaper and less desired products, such as hamburger for steak, the products should not be considered equal. Likewise, when customers switch to discount stores that offer less service, their money does not buy as much satisfaction.

The CPI already includes extensive adjustments for product quality even though consumers often have no choice about new features, while quality deterioration, such as stonewalling by companies over insurance claims, downgrading of air travel comfort, and the frustration of automated telephone systems, is ignored. Product improvement certainly does not apply to meat because the Agriculture department now gives the "choice" label to products that would not have qualified before the 1980s. Price reductions as newly introduced products reach mass markets are, of course, irrelevant to people who wait for affordable prices instead of following fads.[16]

As Congress continued in 1997 to use CPI revision for a back-door invasion of Social Security, trade associations became very inventive, as revealed in a syndicated column by Marilyn Geewax. To "prove" prices haven't been going up, she quoted the American Petroleum Institute on gasoline, the National Cattlemen's Beef Association on food, and the National Broiler Council on chicken—respectable trade associations but hardly impartial!

The oil industry used the device of measuring cost by the mile rather than the gallon, ignoring the consumer's expense of acquiring a car with better gas mileage. No claim was made that the gasoline at a higher price per gallon was any better quality. The beef industry said families spend a smaller percent of disposable income on food, but didn't mention the shift away from beef. Again, the higher price of their product, beef, went unmentioned. The poultry industry relied on over 50 years of factory workers' wage gains to show they could buy more chicken—measured per hour of wages rather than per dollar.[17]

Unmeasured inflation

Greenspan has been credited by financial and business speakers for stopping inflation, yet, as suggested above, some price increases don't show up in the official index. Without going into detail about procedures or problems of the FRB at this point, let's look at forms of inflation that have existed but not been recognized in the official statistics. One built-in factor is the cost of higher interest payments resulting from FRB inflation fighting.

In 1991 economist Edward Hyman of the ISI Group invented something he called "the New Misery Index" (echoing the political concept of the Misery Index equal to the sum of unemployment and inflation rates that had described stagflation). Hyman constructed his index by combining the rise in taxes, medical payments, social security contributions, and interest payments as a percentage of personal income. Those four categories, which took 24% of personal income in 1960, had risen to 40% by 1990—with the largest increase coming during the 1980s.

Kevin Phillips (1993) described some of the hidden costs mainly missed by the official index during the 1980s: virtually unregulated inflation in the cost of health care, automobile insurance, legal and financial services, bank fees, and college tuition; the prices of small items from weekly newsmagazines and shoeshines to contact lens solution and per-hour charges at parking garages that were soaring at three to four times the CPI rate; and the onrush of governmental charges ranging from federal taxes to miscellaneous governmental fees.

Deregulation and lack of needed new regulation also led to high bank charges and soaring fees for cable television, insurance, legal services, and health care. Banks increased costs to their customers by raising service charges, levying new fees, and posting high personal loan and credit-card rates while paying unprecedentedly lower interest rates on customers' deposits.[18]

Monetary policy, according to Galbraith, is a "blunt, unreliable, discriminatory and somewhat dangerous instrument of economic control" surviving partly because it is hard to understand and because resulting high interest rates are welcomed by banks and others with money to lend.

When credit rationing occurs, "it is the small firm that finds itself unable to borrow. Hence, for competitive industries—farmers, small builders, small retailers, service industries, dealers—monetary policy is effective. It will be easy to see why monetary policy is regarded with equanimity and even approval by larger and stronger firms. Unless applied with severity over time it does not appreciably affect them" as they have stronger banking connections and the ability to finance projects from retained earnings or by going directly to the market.[19]

25. THE TROUBLE WITH BANKS

Willie Sutton once was asked why he robbed banks. His answer: "That's where the money is." His answer would also fit the question: "Why do state and federal laws favor banks against private citizens?" Bankers' associations are big contributors to political campaigns and are powerful lobbyists. Many years ago banks got the states to pass laws making it *legal* for them to send "repo men" to break into a car in the dead of night and take it from the driveway of an owner who is behind in payments. Anyone else caught doing that would be up for grand theft auto. They are just following the pattern of the railroads in the 19th century who were said to have a majority of the members of the state legislatures on their payrolls.

Banks and bankers have a very conservative image, partly stemming from the experience of ordinary people who ask them for a loan. Under some circumstances, however, they act like reckless gamblers, although always arranging it so that the public will cover their losses. While local business entrepreneurs plead for bank loans and are often rejected by loan officers who demand collateral and personal guarantees, the same bank may be making huge loans to foreign governments that are already delinquent on previous loans and highly unpopular with their own oppressed citizens.

In the 1970s banks also gambled extensively in financing the overbuilding of condominiums and apartments in southern Florida and had to write off many loans at a fraction of their value. During the 1980s more than a trillion dollars went into commercial office space, shopping malls, and multi-family developments in loans from the banks, along with the S&Ls and insurance companies.

Leveraged buyouts in the 1980s, financed by junk bonds and $50 billion of bank loans at high rates and enormous fees, did nothing to increase production, while saddling corporations with huge debt. For example, a $535 million loan to buy out Revco Drugs brought in $20 million in fees. In December 1990 the

Revco loans were selling at 60 cents on the dollar, and Federated Department Store loans were selling at 45 cents on the dollar.[20]

To keep banks out of the securities business, where they had helped cause the 1929 stock market crash, Congress had passed the Glass-Steagall Act of 1933, which barred banks from buying or underwriting corporate stocks and bonds. Yet in 1990 the Secretary of the Treasury assured the securities industry that the Bush administration would work for the repeal of Glass-Steagall, and banks continued to press for expanded investment powers during the Clinton administration.[21] Proposals were pending in 1998 in both the U.S. Senate and the House of Representatives to allow the common ownership of banks, insurance companies and securities companies. In addition the antitrust laws have been bent to let big chains of banks swallow up their competition.

Nobody is stopping banks and finance companies from promoting "home equity loans," which are highly risky for the borrowers. These are the same as "second mortgages" that resulted in so many families losing their homes in the 1930s. "Never again!" was the mood then, but tax law changes during the 1980s provided a tax advantage for second mortgages. Banks' overpromotion of credit cards also encouraged families to build up a dangerous amount of debt.

Passing costs and risk to customers

As bank credit cards came into use, banks got the usury laws changed to let them charge up to 21% interest, while they paid their depositors as little as 2%. By 1996 personal bankruptcies exceeded a million, largely as the result of overpromotion of credit cards, and the credit industry moved to tighten the screws on its customers. Their National Consumer Bankruptcy Coalition's members had donated over $700,000 to federal campaign funds in the first half of 1997 alone. The American Financial Services Association lobbyists got more than 150 members of the House of Representatives to cosponsor its "Responsible Borrower Protection Act" by December 1997. The bill would make it more expensive to get into bankruptcy, lengthen the required repayment period, and prevent debtors from

making mortgage or child support payments ahead of credit card debt.[22]

A prime example of putting customers at risk is a set of amendments to its bank service agreements that were circulated to Virginia and Carolina depositors by BB&T (Branch Bank & Trust), effective September 1, 1997, reducing the bank's liability for paying fraudulent telemarketer drafts and forged checks. The bank is to be excused from liability "without regard to the Bank's care or lack of care" not only if the depositor fails to report improper charges promptly, but also if the checks are "altered so cleverly [that it] could not be detected by a reasonable person."

Likewise, the depositor is to be liable for any demand drafts from telemarketers using the account number and "in lieu of manual signature, a legend such as 'Payment Authorized'" unless the depositor has not given the account number to the telemarketer. This, like another rule demanding that the depositor safeguard access to checks and account numbers, opens up a Pandora's box of legal quibbles that could shift the burden of proof to the customer.

It is understandable that most bank transactions now are handled by computer, untouched by human hands, but the important question is what the bank will do when a fraudulent transaction is discovered. Will the bank correct the error and reverse the fraudulent transaction (charging it back to the originating source), or just dodge responsibility under these new rules?

A bank officer of BB&T, when asked about the amended rules, explained about electronic processing and gave oral assurance that errors would be corrected (thus contradicting the written rules). He claimed such problems were rare, which makes one wonder why the bank would impose losses on the very few of its customers unlucky enough to be cheated. He also asserted other banks would be establishing similar rules.

A small businessman, Fred D. Curl of McLeansville, writing in the letters column of the August 23, 1997, Greensboro (NC) *News & Record*, claimed the bank he had used since 1960 already imposed a similar policy. The bank refused to make good when "someone stole the company's checks, forged my

name and altered the checks." The bank told him to bring in the forged checks, and "after they kept the checks for a few weeks, they said there was nothing the bank could do."

Concentration of power

Congress enacted legislation in 1994 giving banks the power to establish branches nationwide. As of June 1996, over 70% of U.S. banking assets were controlled by less than 1% of the banks, namely the 100 largest banking organizations. The largest, Chase Manhattan-Chemical (the result of big merger after big merger), had assets over $300 billion.

A proposed merger announced April 6, 1998, of Travelers Group with Citicorp into Citigroup, Inc., was to set a new record for size, with each company's market value over $70 billion. The pool of customers includes 70 million in the U.S. alone and 100 million in 100 countries. Proclaimed as a convenience for customers, the merger would combine a wealth of financial information about those customers that would help the sales efforts of the new company.

Since Travelers had already absorbed the Salomon Smith Barney investment house, the Citigroup merger is to combine global banking, insurance, stocks and bonds, all in one mega-corporation. They are betting, according to the Associated Press, "that Congress will change Depression-era laws prohibiting banks from getting into the insurance or brokerage businesses." The financial community has lobbied Congress intensively to repeal those laws, while financial companies used holding companies and other devices to outflank the spirit of the laws.[23] The expectation that the 1933 Glass-Steagall Act would be repealed was characterized as "remarkable chutzpah" by William Safire, a columnist usually more friendly to business interests than to government regulators.[24]

The perils that the New Deal legislation attempted to prevent were illustrated by NationsBank's $6.75 million settlement with the SEC, the Comptroller of the Currency, and the National Association of Securities Dealers of charges of "deceptive and misleading sale of securities on the bank's premises" to investors who were mostly elderly. In the May 4,

1998, settlement the company neither admitted nor denied wrongdoing, but it issued a statement that it had taken steps to avoid repetition of the problems. NationsBank had paid nearly $40 million in 1997 to settle a class action lawsuit by former customers in Florida and Texas based on similar charges.[25]

NationsBank Corp. and BankAmerica Corp. announced on April 13, 1998, a $62.5 billion merger resulting in the nation's first coast-to-coast bank. At the same time, a $28.9 billion merger of Banc One and First Chicago NBD to create the Midwest's most dominant bank was announced. News reports did not even mention any possibility of objections on antitrust grounds.

Ranked by assets on December 31, 1997, Citigroup would be largest of the U.S. banking companies at nearly $700 billion, BankAmerica second with $568 billion, Chase Manhattan third, J. P. Morgan fourth, and Banc One fifth with $240 billion. On the global scene, U.S. banks would still fall short of the size of Japan's Bank of Tokyo-Mitsubishi and the proposed United Bank of Switzerland.[26]

One result of bank concentration is the creation of even stronger political lobbying forces. Another is establishing banks so large that the taxpayers will always be at risk to bail them out, as regulators and politicians will declare their failure a threat to the entire financial structure of the nation. As some of the risky ventures of the 1980s began to fall apart bank failures loomed, but Washington decided to save the big banks and big depositors from the consequences of a free market. When the nation's eighth largest bank, Continental Illinois, was on the verge of failure in 1984, the FDIC saved it by guaranteeing all of its deposits, not merely those under $100,000 covered by the law. This set a precedent for other big banks that could bring the economy down if they failed.[27]

Despite this increasing risk, the FDIC in 1995 eliminated deposit insurance premiums for 92% of the nation's banks and capped the reserves that financial institutions pay into the government's bank insurance fund at $25 billion, just 1.25% of the insured deposits.

Dubious claims of efficiency

Like other businesses seeking to justify mergers, banks typically claim that the larger combined entity will be more efficient and provide better service. Objective evidence seldom supports these claims. For example, Stephen Rhodes, a veteran economist with the FRB, reviewed dozens of studies and found "little support" for the view that bank mergers result in improvements in performance. John Boyd, formerly at the Federal Reserve Bank of Minneapolis, and his colleague, economist Stanley Graham, found that most economies of scale are exhausted when banks reach $100 million in assets.

Another study by Allen Berger and Joseph M. Scalise of the FRB in collaboration with Anil K. Kashyap of the University of Chicago estimated that for banks with less than $100 million in assets nearly 82% of their loans went to business borrowers with less than $1 million in bank credit, but for larger banking corporations only 0.7% of their commercial loans went to such smaller companies.[28]

Federal Reserve Governor Janet Yellen told the House Banking Committee in 1995 that banks in concentrated markets "tend to charge higher rates for certain types of loans, particularly small business loans, and tend to offer lower interest rates on certain types of deposits than do banks in less concentrated markets."[29]

Banks in the oil crisis

The double-digit inflation that reached its peak in 1981 was initiated by OPEC's sharp increases in the wholesale price of oil. The major oil companies conspired, as was later proved, to create a false scarcity and long lines of motorists at the gas pumps. The resulting public panic enabled them to further increase prices, trim costs by introducing self-service, and add extra profits for themselves on top of the increase in wholesale prices. It also gave them an excuse to limit deliveries and force independent service stations out of business in favor of their company-owned stations. The higher prices of petroleum products used in manufacturing

and transportation led to higher prices of other goods throughout the economy.

It is significant that this inflation was abetted by bankers, who normally regard inflation with great dread, especially whenever wages rise or unemployment falls. The bankers made loans to less developed countries for purchases of oil at inflated OPEC prices. Because money from OPEC profits was flowing into the banks and being loaned out for more oil purchases, this process was sometimes called "recycling." Two harmful results were (1) fueling inflation and (2) debt burdens on the borrowing countries.

If it had been left to the market mechanism of supply and demand, the oil producing countries would have had to reduce their cartel's prices or be unable to sell their oil. Instead, the banks made high-risk loans to finance high-priced oil purchases that enabled OPEC members to deposit more money in the banks. With this financing mechanism in place, OPEC oil revenues were $74 billion in 1974 and $300 billion in 1980, compared with only $7 billion in 1970.

Why did banks make loans that appeared, on the face of them, so imprudent? For one thing, the interest rates they charged were extremely remunerative, and for another, banks take the attitude that nations don't go bankrupt; no matter how bad their financial situation, they can always get more money from taxes. At those interest rates, the banks would be content to roll the loans over and just keep collecting the interest. In some cases foreign loans have specific government guarantees. If not, banks tend to rely on their belief that the public will be forced to bail them out in the end, as in the case of the savings and loan fiasco.

The Feb. 2, 1983, testimony of FRB Chairman Volcker to the House Banking Committee was quoted by Quirk & Bridwell (1992): "At the time oil prices first rose sharply, great concern had been expressed that industrialized and developing countries alike might be unable to finance the increased cost of oil imports," and they questioned, "Why should we worry about 'financing' an economic war aimed at us?" As they pointed out, the result was a distortion. "The price of one commodity was allowed to rise, which would ordinarily mean that the price of all other goods and

services must fall. Arthur Burns' Fed, and later, William Miller's, however, created new money to keep this from happening."

They compared this with bankers' sale of German bonds to the American public after World War I (for reparations to England and France) as well as bonds of other foreign countries. By 1933, $25 billion of foreign bonds were in default, and the bankers made no apologies for selling the bad bonds to the public. In the OPEC operation, they claimed, "The bankers, if they told the truth, would have to write off almost $400 billion of bad loans....The losses, the banks say, should be shifted to the taxpayer....In November 1982...FRB Chairman Paul Volcker told bankers to keep on lending: 'New credits should not be subject to supervisory criticism.'"

The same authors noted that after Sadaam Hussein invaded Kuwait in 1990 and the Bush administration sent 300,000 troops to the Gulf, "the administration said it sent the troops to the Gulf to prevent Sadaam from gaining control of the world's oil supply." However, the government neither took nor threatened military action as the price of oil ran from $3 a barrel in 1973 to $39 a barrel in 1979.[30]

26. THE GREAT S & L ROBBERY

The public was told, falsely, that the troubled savings and loan associations had to be bailed out by the taxpayers. S&Ls are not banks, but since the 1970s and 1980s laws and regulations have made them almost indistinguishable. S&Ls, along with the savings banks, are known as thrift institutions and have a long, respectable history. Commercial banks originally had the exclusive right to take demand deposits (checking accounts). They also did commercial lending, could accept time deposits (savings accounts) and lend to homeowners against mortgages.

The S&Ls were created to make more funds available to finance home purchases, using funds deposited in savings accounts by individuals. Savings banks grew up in the northeastern states, and were non-profit mutual associations operating much like savings and loans. The thrift institutions were allowed by the government to pay slightly higher interest than the commercial banks.

Two things changed: (1) non-profit mutual thrifts were allowed to be converted to private corporations and become part of the corporate merger movement; and (2) restrictions on their operations were relaxed, largely in response to the pressures they felt from rapidly rising interest rates after the oil shocks. As market interest rates soared, S&Ls were at a disadvantage in competing for deposits against other investment opportunities such as bank certificates of deposit (CDs), bonds, stocks, and mutual funds. The home mortgages they had written at fixed rates before interest rates soared produced little revenue and lost market value for resale.

The unrealized losses of the S&Ls had reached $200 billion by 1982, according to Quirk and Bridwell (1992), but they wrote: “Even if the government had to buy all the outstanding

mortgages at face to provide funds for depositors there would be little or no ultimate loss because the value of the mortgages would get back to face as interest rates fell....The S&Ls were insolvent measured by generally accepted accounting principles (GAAP). Congress let the Bank Board change the accounting rules so they'd be solvent. The rules were called RAP or regulatory accounting principles....The most metaphysical things, such as 'goodwill,' could be counted as assets."[31]

The S&Ls had a problem that would remain until interest rates dropped back to a normal level, but the solution was worse than the problem. In 1982 a new federal law allowed S&Ls to change the investment of their funds from the traditional home mortgages to other ventures, including commercial real estate, junk bonds, mortgage backed securities, futures, puts and calls, and repurchase agreements. "Like banks in the 1920s," Kevin Phillips commented in 1990, "many S&Ls proceeded to gamble, with their (federally guaranteed) deposits, and by 1988 many had lost."[32]

The original idea of insurance for deposits had been to protect ordinary people with small savings accounts. The coverage grew from the original $10,000 to $15,000 in 1966, then jumped from $40,000 to $100,000 in 1980. That last sharp increase was railroaded through the Congress without any hearings or floor debate nor any record in the Senate of who voted for or against it. The new limit helped to make the burden too heavy for the Federal Savings and Loan Insurance Corporation (FSLIC) to handle. The Federal Home Loan Bank Board, which had prohibited S&Ls from getting more than 5% of their deposits from deposit brokers, removed that prohibition in 1980. As the rules were relaxed, money flowed into the weakest thrifts, which were generally those with the highest interest rates.

As Jim Adams wrote in *The Big Fix*: "[The risky] thrifts grew a thousandfold and more in just four years and kept growing as their losses mounted." Quirk and Bridwell added: "Many of the traditional S&L officers left the industry and were replaced by a bunch of crooks. Almost all of the large S&L failures show a change of ownership in 1982 or 1983 as the crooks came in." As

the FSLIC ran out of money it could not close insolvent S&Ls because it had no money to pay off depositors. The losses rolled on, the honest S&Ls continued to be squeezed, and the crooked S&Ls gambled with taxpayer-guaranteed funds.[33]

In 1988, a presidential election year, the Republican president and the Democratic congress kept the public in the dark about the S&L crisis, while the news media kept the public's attention elsewhere. The government assembled insolvent or almost insolvent S&Ls into groups and sold them to private buyers at low prices sweetened by huge tax breaks and subsidies. The General Accounting Office later estimated the cost of these tax breaks to the government at $8.5 billion.[34]

Under a 1981 law, due to expire at the end of 1988, S&Ls could take a tax loss on the sale of property even when the government guaranteed it against loss and paid in cash so it didn't have a loss! Before this gimmick expired 199 seized S&Ls were sold by the Bank Board in 1988 to private buyers, whose deals in the last week of 1988 cost taxpayers an estimated $70 billion.

For example, Quirk and Bridwell, quoting Mayer,[35] reported that Ron Perelman paid $315 million for First Gibraltar and Vernon Savings and got tax deductions valued at $897.3 million, as well as assets listed at $12.2 billion supported by a $5 billion FSLIC assistance package. They added: "In 1989...First Gibraltar reported payments from the government of $461 million and net profit to Perelman (tax-free) of $129 million."[36]

Why taxpayers bailed out the S&Ls

After massive propaganda, most taxpayers probably believe they were legally obligated to bail out the savings and loans. Quirk and Bridwell stated: "The President, Congress, and the media all tell the taxpayer he is legally obligated. But it's not true." Federal liability was limited, of course, to the assets of the Federal Savings and Loan Insurance Corp. (FSLIC) and then to its successor, the Federal Deposit Insurance Corp. (FDIC).

They listed the government's options in early 1989 as (1) do nothing, which would cost the taxpayer nothing, (2) pay for the S&L losses with taxes at a cost of $130 billion, or (3) pay for the S&L losses with 20-30 year bonds at a cost of $500 billion (noting that the second and third options were subject to being doubled or tripled). The third and most expensive option was selected.

The reasons offered by FRB Chairman Greenspan at a hearing of the House Banking Committee for making the taxpayers shoulder this burden were: (1) basic benefits to the economy as a whole and (2) to avoid the deposit withdrawal and losses "that disrupted the payments system and the savings and investment process in the 1930s."

American public gets stuck with the bill

The Reagan economists had estimated the S&L bailout price might reach $50 billion. By April 1990 the estimate reached $500 billion and growing, according to Haynes Johnson, "bigger than all the bailouts of New York City, Chrysler, and Lockheed put together and far exceeding the cost of the Marshall plan....Some experts reckoned the overall cost to be twice as much as the entire Vietnam War in comparable dollars and nearly four times that of the Korean War!"

The *1990 Economic Report of the President* stated: "The irony is that Federal Government policies have led to this debacle." Typical of government reports, the culprits were not named.[37] The bailout was not restricted to deposits within the $100,000 limit. Nor was there any provision for the inadequacy of FSLIC or FDIC insurance reserves to be made up by higher future premiums from the S&Ls. The politicians decided instead to pass the buck to the taxpaying public. In fact, people who had no money to save after basic necessities would be taxed to make up losses of those who deposited even more than $100,000 with high-paying but risky institutions. Talk about redistribution of wealth!

This solution was worked out behind the scenes between politicians of both parties and the powerful S&L lobbies. Allowing conversion of mutual S&Ls and savings banks into stock companies, and the merger of such companies, had done much to strengthen the political influence of the thrift institutions. No wonder there was a conspiracy of silence during the 1988 election campaign.

With the election over, Washington quietly arranged for the bailout to be financed by 30-year federal bonds to be issued by a quasi-governmental corporation so that it would be off-budget although adding $500 billion to the national debt. Economists at Stanford University calculated that total outlays might reach $1.3 trillion, with $900 billion representing interest payments alone.

At about the same time, as reported by columnist Warren Brookes, FRB Chairman Greenspan moved Federal Reserve deposits to troubled institutions, including Lincoln Savings and Loan, and loaned nearly $100 million to Lincoln, delaying its failure for four months (until Apr. 13, 1989) "to allow all those depositors with accounts of more than $100,000 to get out 'whole' from the Lincoln mess without losing a dime."[38]

Greenspan described the S&L costs to the *Financial Times* as illusory, just a transfer of money from one pocket to another that does not affect our productive resources. He omitted that the transfer was from the taxpaying public to financial wheelers and dealers. The guilt of both major parties was made clear by Ralph Nader: "Congress went along with President Bush's demand (under threat of vetoing his own bill) to remove the bailout from the federal budget....The bipartisan effort to hide the cost of this calamity continues apace."

The bailout was entrusted to an unwieldy bureaucracy called the Resolution Trust Corp., which budgeted $500 million for 1990 to be paid to outside lawyers and continued to encourage mergers and takeovers. Chairman J. S. Seidman announced in 1991 that $100 billion of properties would be sold in bulk to big buyers who would make only a small down payment and agree to

pay part of future profits, *if any,* toward the rest of the purchase price.[41]

Making out like bandits

Although President Bush, attributing the S&L crisis to dishonesty, announced an all-out investigative and legal war on the culprits, relatively little came of it. Most of the problem originated with the government itself for encouraging risky speculation with depositors' money and tolerating shady practices. People who came to control the S&Ls, however, sailed close to the law and sometimes over the edge, but they tended to have friends in high places who let them off the hook.

One of the S&Ls that failed was Silverado Banking, Savings and Loan of Denver, whose board of directors included the President's son, Neil Bush, who loaned millions to his friends and business associates (most of which they did not repay) and received $500,000 himself plus millions for his failing business. He was reprimanded by federal authorities after Silverado failed, requiring a $1 billion bailout, but the brief flurry in the media quickly died down.[42]

The other failure involving a Presidential family didn't fade away so quickly. This was Madison Savings and Loan in Little Rock, Arkansas, and its connection with the Whitewater development in which Bill and Hillary Clinton were involved. Although it happened long before Clinton's election, Republican special prosecutors spent over $40 million, and Republicans in Congress spent more millions trying to turn Whitewater into the same disaster for the Clintons as Watergate had been for Nixon. It was still being investigated in 1998, but Special Prosecutor Kenneth Starr then turned his attention to the Monica Lewinsky sex scandal that he submitted to Congress as possible grounds for impeachment.

There was no shortage of other political connections with S&L principals. In the biggest failure of all, the $2.6 billion Lincoln Savings scandal for which Keating was convicted in 1991 and went to jail, the intervention of five Senators—Alan Cranston

(Calif.), John Glenn (Ohio), Don Riegle (Mich.), Dennis DeConcini (Ariz.), and John McCain (Ariz.)—had delayed its being declared insolvent by the Bank Board from 1987 to 1989.

Vernon Savings, a Texas S&L that was bought by Don Dixon in 1982 and failed in 1987, owned a 112-foot yacht moored on the Potomac River, on which the Democratic Congressional Campaign Committee held eleven fund-raising parties in 1985 and 1986. Dixon was sentenced to five years in prison for making illegal campaign contributions through Vernon Savings to Speaker Jim Wright, House Majority Whip Tony Coehlo, Senator Jake Garn, and Senator Alan Simpson.

Control of another Texas S&L, Gibraltar Savings, was acquired in 1983 by former Democratic National Committee Chairman Bob Strauss with his son and a colleague. It was seized by federal regulators in 1988 and sold, with tax incentives, to Ron Perelman.[43]

Some of the politicians involved with the S&L crisis were Republicans and some were Democrats. There were probably few, if any, members of Congress who did not receive large political donations and favors from individual savings and loans and their national association. That is the only explanation for the way the crisis was settled at the expense of the general public.

To Kevin Phillips in *Arrogant Capital* (1994) the S&L rescue operation was just another step in the bipartisan corporate welfare process of bailouts under which "Lockheed was saved in 1971 under the Republicans, Chrysler in 1979 under the Democrats, Continental Illinois Bank in 1984 and several big Texas banks during the mid-1980s under the GOP." He said Bert Ely, a Virginia-based banking consultant, calculated that the financial institutions forced into FDIC and FSLIC rescues in the late 1980s and early 1990s held a higher percentage of total national deposits than the institutions that failed outright in the late 1920s and early 1930s.

"This time," Phillips pointed out, "abuses were protected. Shareholders did not lose their shirts, and the big depositors generally got paid off by federal authorities even when their

multimillion dollar deposits were far above the insurable limits." Furthermore, the FRB drove down interest rates and "shaky banks reveled in huge gains on the spread between high long-term interest rates and low short-term borrowing costs....By the mid-1990s, banks and investment firms were not only liquid again, but had enjoyed several years of high profitability."[39] It is probably not coincidence that banking and finance led the categories of political action committee (PAC) contributors to Congressional candidates during some 15 years from January 1981 through November 1996 as reported by Common Cause.

27. MAN-MADE GLOBAL DISASTER

As the American economy has been put in a straitjacket by bankers who run the Federal Reserve, much the same has happened on the global scene. Just as war is said to be too important to be left to the generals, world finance is too important to be left to the bankers, but the bankers of the World Bank (or International Bank for Reconstruction and Development) and the International Monetary Fund are dictating the global economy.

Those two international organizations are nominally arms of the United Nations, but operate largely outside the control of any government and cooperate with each other to structure the world to their liking. Both were created at the Bretton Woods Conference in 1944 and have grown enormously since then. The IMF was established to maintain stability in the exchange rates of the currencies of member nations. The World Bank's mission was to make loans (and insure private loans) to assist the growth of underdeveloped countries. Later the IMF got into the business of loans and loan guarantees with strings attached.

These international bodies are as much permeated with true believers in pre-Keynesian classical economics (recycled under new-sounding names) as are the Federal Reserve System and other organs of establishment economics. On the international scene, the buzz-word is "neo-liberalism," construed, strangely enough, to mean the sovereignty of private enterprise. In practice, it results in "liberating" multinational corporations to engage in exploitation of workers and natural resources without interference from government.

The rulers of Planet Earth are compared by David C. Korten to episode 74 of "Star Trek": This episode "took place on the planet Ardana...whose rulers devoted their lives to the arts in a beautiful and peaceful city, Stratos, suspended high above the planet's desolate surface. Down below, the inhabitants of the planet's surface, the Troglytes, worked in misery and violence in the planet's mines to earn the interplanetary exchange credits used

to import from other planets the luxuries the rulers enjoyed on Stratos....

"How like our own world it is, where the truly rich and powerful work in beautifully appointed executive suites in tall office towers; travel to meetings by limousine and helicopter; jet between continents...pampered with the finest wines by an attentive crew; and live in protected estates, affluent suburbs, and penthouse suites amid art, beauty, and a protected environment....They too are living in a world of illusion, dependent on draining the world of its resources and so isolated from reality that they know not what they do, nor how else to live...." At a joint annual meeting of the Boards of Governors of the World Bank and the IMF in Washington, DC, according to journalist Graham Hancock, there were 700 social events in one week that cost about $10 million, and one formal dinner alone cost $200 per person.[40]

The World Bank and the IMF impose what they call "structural adjustment." They tell countries applying for loans that they must reduce government help to their citizens, sell off government-owned operations to private investors, remove price controls on food, and open their markets to foreign competition. This has caused impoverishment, unemployment, and growth of slums, but created opportunities for multinational exploitive and polluting industries. By contrast, the World Bank and IMF have never, to my knowledge, required crooked politicians in these countries to repay the loot they stashed in foreign bank accounts.

The World Bank bidding procedure, which ignores externalities (results that don't affect the company's profits), tends to favor large foreign corporations with the resources to create successful bids. This forestalls the development of local industries. "We have been witnessing the transfer of public funds from the wealthy industrialized nations to developing countries," according to Greenpeace energy expert John Willis, "so that they can be sent right back—with interest—as profits" for oil, coal, and nuclear industries, and interest to banks.[41]

It is significant to remember that these agencies are not at all answerable to the citizens of the nations they affect. They are answerable to the UN, at least theoretically, but under the UN's

present charter might makes right in the Security Council and representation in the General Assembly is highly disproportionate to population. In fact, all posts in the UN are filled by governments, none by election (unlike the European Community, which chooses its parliament by election).

In a 1993 speech, Krugman traced the evolution of the conventional wisdom on international economic affairs from the 1920s belief in free markets and sound money, through the 1940s World Bank policy of industrialization to substitute for imports, and the 1970s prescription doing away with import substitution, to the late 1980s reversion to free markets and sound money. "Like any conventional wisdom, it was based more on the circular process of important people reinforcing each other's current dogma than on really solid evidence...."[42]

During the tenure of Robert McNamara as president of the World Bank 1969 to 1981 "structural adjustment loans" began to force debtor countries to accept trickle-down economic policies that have caused great suffering in the Third World. I had cheered for McNamara when he was brought in by President Kennedy as the whiz kid from Detroit to head a more unified Defense Department and make the Pentagon efficient. Remaining under Johnson, he doggedly pursued the Vietnam War, which he later confessed was a big mistake. His appointment to the World Bank seemed like a chance to redeem himself, but instead he managed to do great harm in another important field! McNamara was quoted as declaring land reform off limits because it would "affect the power base of the traditional elite groups in the developing society" who could subvert Bank policies if alienated.[43]

Global banking; the new colonialism

The tragedy of poverty and starvation in Africa resulting from programs that were supposed to raise living standards by development were explained by Richard Lombardi, a former vice-president of the First National Bank of Chicago in charge of lending in Africa, in his book, *Debt Trap: Rethinking the Logic of Development.* This failure occurred because governments have forced farmers off their land or induced them to raise export crops rather than food for local consumption. Many farmers have

moved to the city and many more have switched to crops for export, like sugar and coffee and cola nuts. The governments, in some cases, have made deals with multinational corporations to share in profits from mining operations that drive native populations off their lands either by using military force or by contaminating their sources of livelihood, resulting in cities crowded with unemployed, homeless adults and children.

In 1989, as ongoing World Bank projects were displacing 1.5 million people and new plans threatened another 1.5 million, Bruce Rich asserted Bank staff were unable to point to a single bank-funded project in which the displaced people had been relocated and rehabilitated to a standard of living comparable to what they enjoyed before displacement.[44] The World Bank's own studies show many of its projects to be failures, even on its own terms. A 1992 study of Bank-funded projects completed in 1991 found that 37.5% were failures at the time of completion. An earlier study found that 12 of 25 projects that the Bank had rated as successful at the time of completion turned out, when followed up after four to ten years, to be failures.

Under pressure from the global bankers to attract foreign investors, governments have suppressed labor unions and held down wages, benefits, and labor standards. They have given special tax breaks to foreign corporations and relaxed environmental regulation. As international debt collectors, according to Jonathan Cahn (1993), the World Bank and the IMF have imposed consultants who often rewrite a country's trade policy, fiscal policies, civil service requirements, labor laws, health care arrangements, environmental regulations, energy policy, resettlement requirements, procurement rules, and budgetary policy.[45]

IMF intransigence

The IMF, originally established to help Western countries stabilize their currencies under fixed exchange rates, redefined itself in the 1970s era of floating currencies and began offering loans to developing countries in exchange for strict "structural adjustment" programs of austerity and deregulation. Now it has taken on an additional role guaranteeing the loans of private

international bankers—free of cost to the lenders, but causing great hardship to ordinary citizens.

Since 1989, the U.S. Congress has tried to influence the IMF by provisions in funding legislation requiring official U.S. representatives (known as "executive directors") to use "voice and vote" to promote "long-term sustainable management of natural resources, the environment, public health and poverty." Seeing little result, in 1992, the U.S. Congress tried to remove any possible ambiguity about promotion of anti-poverty and pro-environment programs, policy audits, and public access to information by providing a detailed list of specific policy recommendations. Still this did not lead to changes other than rhetoric. The IMF changed the job description of one of its senior economists, Ved Ghandi, to include environmental issues, resulting in papers explaining why the IMF should not be involved in environmental issues.

In 1994, the Sanders-Frank Amendment to the Foreign Operations Appropriation Bill, further required U.S. executive directors to push for international financial institutions, including the IMF, to encourage guarantees of worker rights under International Labor Organization (ILO) conventions, such as the rights of association and collective bargaining, a minimum wage, maximum hours of work, occupational safety and health protections, and prohibitions against forced labor. Instead of reporting on its progress in promoting these reforms after one year, as specified, the Treasury Department took almost three years and then merely offered ideas on how to begin implementing the Sanders-Frank amendment.

Also in 1994, frustrated with the lack of IMF responsiveness, Congress withheld three-quarters of a $100 million proposed contribution, urging that the IMF be opened up to more public scrutiny. The power of the purse finally caused the IMF to remove the secrecy from some of its documents, but still, according to economist Jeffrey Sachs, "the IMF provides virtually no substantive documentation of its decisions as the documents are shorn of the technical details needed for serious professional evaluation of the program."[46] Congressional efforts to make

reform language enforceable have been hampered by the lack of recorded voting and by secrecy of Board discussions at the IMF.[47]

They know not what they do

Korten described the 1991 meeting of World Bank and IMF directors in Bangkok to show how the global bankers are shielded from seeing poverty where projects have been financed with their loans. In the shiny new convention complex rushed to completion by the government of Thailand in downtown Bangkok, they did not have to see where 200 families were evicted from their homes to widen roads nor a squatter settlement that was leveled. They were spared the normal traffic congestion and air pollution because schools and government offices were closed. "Bangkok, a once beautiful city," he wrote, "has been ravaged by the consequences of its development 'success.' ...On more than 200 days a year, air pollution in Bangkok exceeds maximum World Health Organization safety limits, and emissions are increasing by 14% a year."[48]

A few examples from around the world will illustrate the unfortunate results of the policies of these international bankers, as interest payments took up a portion of government budgets that increased in Latin America from 9% in 1980 to 19.3% in 1987, and in Africa from 7.7% in 1980 to 12.5% in 1987.[49]

Haiti

In Haiti, after the military dictatorship was removed from power and the elected president Aristide returned with U.S. help, the IMF, the World Bank, the U.S. Agency for International Development, and the Inter-American Development Bank offered to help Haiti rebuild, but the economic program they imposed was the so-called "neo-liberal" structural adjustment that bankers have favored around the world. Similar plans forced on Haiti's neighbors—Mexico, Nicaragua, and Venezuela—were supposed to reduce poverty and external debts. Instead they widened the income gap, increased poverty, and undermined national sovereignty. These conditions involved privatization of state-owned industries, deregulation of the economy, and opening the country to massive foreign investment.

Earlier international programs had already undermined Haiti's self-sufficiency, so that in ten years rice production dropped from 100% to 50% of the rice consumed in Haiti. In 1986 the World Bank had convinced the Haitian government to slash the tariffs that protected domestic rice production, so peasants have been abandoning the rice bowl in the Artibonite valley and fleeing to the city in search of illusory jobs, while the valley's intricate irrigation system is falling into disrepair. Also in 1986, under pressure from the U.S. and the World Bank, Haiti's government sold off the state-owned sugar mill to the wealthy Mevs family, who shut the mill and opened a sugar importing business.

In September 1995 millions of dollars of aid were withheld to force the Aristide government to speed up privatization. The World Bank has called for privatization of nine state-owned businesses, including the telephone, electric, flour, and cement companies, although all nine state enterprises had been made profitable before the 1991 coup that ousted Aristide. The bankers urge exports to pay the interest on their loans and finance the products, such as rice and sugar, that now must be imported.

Most of the plants that assemble apparel for export are tax-exempt for ten years or more and use imported raw materials. Piece-workers make as little as 87 cents a day, despite the minimum wage of $2.40 a day, and the U.S. Agency for International Development "has no position" on violations of minimum wage law. Workers at the Seamfast company, stitching nightgowns that sell for $25 in the U.S., receive one and one-half cents per nightgown.

The only ones who prosper in Haiti are the business elite who make their money through import/export business or collecting rents, and look forward to getting a piece of privatized businesses, profiting from expanded imports and exports, and enjoying freedom from government regulation.[50]

To attract foreign investment, according to Friends of the Earth in 1998, IMF has pressured the Haitian government to exploit its low wage labor and abolish its minimum wage, which is only eleven cents an hour.[51]

In 1997 the Associated Press reported that drought was causing starvation and the spread of disease in a crisis that was "the accumulation of years of neglect in which Haiti has gone from near self-sufficiency thirty years ago to depending on imports for 34% of its food needs." The drop in annual rainfall is directly related to deforestation, according to meteorologist Renan Jean-Louis, who said rainfall began diminishing at the end of the 1980s. The AP story concluded with a report from the World Bank that the Haitian farmer has been left with two choices, "either to cut down the few remaining forests" and increase topsoil erosion "or join the exodus to the cities and abroad."[52]

Costa Rica

Costa Rica has long been known as one of the most democratic of Latin American countries with less of an income gap than its neighbors. The IMF and the World Bank have begun to change this, ostensibly to pay off foreign debt.

Thousands of small farmers have been displaced in favor of large agricultural export operations. Increasing crime and violence have resulted in higher police costs, and the country now imports its basic food requirements. Although foreign debt has doubled, Costa Rica has been able to meet its debt service payments, so the IMF and the World Bank call it a success story. Economic growth has increased according to the conventional national production measures that are misleading for the reasons already discussed in the chapter on measuring growth.[53]

Brazil

Between 1960 and 1980 some 28 million people in Brazil were displaced by the conversion of agriculture from producing food for domestic consumption to capital-intensive production for export.[54] Brazil also built up industry, particularly steel, investing money that banks refused New York City because it was a "bad risk," and the steel from its low-wage mills has been driving American steel out of the world market. To repay the loans, Brazil is forced to export still more steel and reduce its imports.

Brockway (1985) commented: "If the bankers' scheme succeeds...additional American steel workers will lose their jobs.

Should the scheme fail, the banks will come crying to Uncle Sam to bail them out...and we will in effect have given Brazil the steel mills that are destroying our industry and putting our fellow citizens out of work."[55]

Mexico

Opening Mexico's borders to U.S. agribusiness uprooted peasants and all but the largest Mexican farmers, as explained in *Zapata's Revenge: Free Trade and the Farm Crisis in Mexico* by Tom Barry (1995). The World Bank, which awarded Mexico 13 structural and sectoral adjustment loans between 1980 and 1991, imposed the following conditions on its 1991 agricultural loan: slashing tariffs, canceling price controls on basic foods, privatizing state-owned monopolies, and eliminating price guarantees for corn—the mainstay of the rural poor.

While Mexico rolled back state support, the U.S. provided billions of dollars that helped U.S. agribusiness drive Mexicans out of business, and U.S. interests gained control of a third of Mexico's food processing capacity.[56] There is a connection between these structural adjustments and the rebellion of native populations in Mexico during the 1990s.

Guatemala

Bloody outcomes resulted in Guatemala from projects supported by the international bankers. The World Bank and the Inter-American Development Bank provided funding and technical support for the Chixoy [chee-SHOY] Hydroelectric Project, a massive dam, reservoir and power station built by the Guatemala state electricity company, INDE. World Bank personnel worked in supervisory capacities with INDE officials at the Chixoy site regularly from 1979 to 1991. The people of the village of Rio Negro, which stood in the path of the project, were forcibly ejected with much bloodshed, because they refused to leave the village unless they were provided fertile land and water instead of the rocky, marginal land they were offered.

In the first massacre, on February 13, 1982, 74 men and women were tortured, raped and murdered. On March 13, 1982, military and "civil defense" patrol units forced nearly 200 Rio

Negro women and children to march several hours up a steep hill, where they began to rape the women, and to kill—some shot, others slashed with machetes, strangled, or beaten with rocks and rifle butts. They killed the children by smashing their heads against rocks.

On May 14, 1982, 84 refugees were discovered and killed by soldiers and patrollers at Los Encuentros. On September 13, 1982, patrollers and soldiers killed 92 people in Agua Fria. They forced them into a community house, machine-gunned them, and burned the house to the ground.

What was the World Bank connection? It was not only involved closely with INDE and the Chixoy Project prior to the violence, but granted an additional $446 million loan in 1985. Bank documents even indicate that in 1984, the Bank hired "an expert on resettlement policy to assist in the [resettlement] supervision function." In 1987, an INDE president described Chixoy as "a financial disaster...which should never have been built." The World Bank in 1991 stated that Chixoy "had proved to be an unwise and uneconomic investment."[62]

Mozambique

A million people died in Mozambique, a Cold War hot spot where rebel forces backed by apartheid South Africa and right-wing U.S. business with covert U.S. government approval fought the Marxist-Leninist Frelimo liberation movement that took over the government in 1975. That occurred after fascism was ended in Portugal and the Portuguese abandoned Mozambique, leaving destruction behind. Halting the economic collapse by 1977, Frelimo restored the economy to pre-independence levels by 1981.

South Africa, which had previously subsidized Mozambique as a buffer against free African nations, began to launch attacks in 1981 and by 1984 the war had devastated the country. As conditions for peace, the U.S. forced Mozambique to join the IMF and World Bank in 1984, to impose a modified form of World Bank-mandated "structural adjustment" in 1987, and in 1990 an IMF-controlled "stabilization."

The IMF said its objective was to curb inflation, even though it had been falling steadily, but after the IMF took charge, it rose from 33% in 1990 to 70% in 1994. GDP per capita, industrial production, and exports all fell dramatically. As the IMF imposed cuts in government spending, salaries fell dramatically; for a doctor from $350 a month in 1991 to $175 in 1993, and less than $100 in 1996. For a nurse or teacher, monthly salaries fell from $110 to $60 to $40—not enough to support a family.

According to author Joseph Hanlon (1996), "the IMF is actually forcing donors—including the World Bank—to give less aid and lend less to the world's poorest country. It argues that post-war reconstruction is inflationary and must be delayed until the economy is 'stabilized.'"[63]

Lesotho

In the small, landlocked nation of Lesotho, which is entirely surrounded by South Africa, the World Bank and other agencies funded the Katse dam, which at a height of 182 meters (600 feet) is the highest dam ever built in Africa.

It is part of a huge, but little-publicized, $8 billion project to export water to the Johannesburg region, the industrial heartland of South Africa. The banks and agencies financing the project were apparently not troubled by the fact that the 1986 treaty for this undertaking was negotiated by the South African *apartheid* government and a Lesotho military government reportedly installed in a coup sponsored by South Africa shortly before the treaty's signing.[64]

India

The World Bank used many loans in the 1950s in an effort to win India away from policies of building local production to displace imports and of government intervention in the economy. The Bank organized aid donors and promised more aid if India moved toward free-market, export-oriented policies. By 1971, the Bank chaired 16 such donor groups, increasing the Bank's policy leverage. Large-scale development projects have displaced 20 million people over a 40-year period.[65]

As part of a $400 million loan package in June 1993 to expand power plants in India, World Bank officials had stipulated that living conditions in Chilkanand and other resettlement sites be improved. Chilkanand is a slum where people were evicted from their homes to make way for power plants and coal mines. An electric line was installed in 1990 and, in September 1994, for a visit to the area by World Bank officials, Chilkanand was connected to the power grid, but a few months later the power was cut off again.[57]

Although the World Bank has a few small sustainable development projects, almost all of its energy loans totalling $9.5 billion to India have financed environmentally and socially destructive projects. Its officials treated Indian government programs for alternative energy as an unwanted source of competition with Bank energy programs, "turning the screws on the Indian government to reduce subsidies for its own programs and shift the focus from rural to urban markets to ensure better returns," according to Roychowdhury and Cherail in the Jan. 15, 1995 issue of *Down to Earth*, published by the New Delhi-based Center for Science and Environment.

The World Bank also opposed the government electrification program for rural areas where 80% of India's poor majority live and 70% do not have electricity, on the grounds of excessive financial risks and inadequate profit margins. After the World Bank withheld $750 million in Indian energy loans to enforce compliance, the Indian government, in 1995, scaled back alternative energy subsidies and power projects in its poorest states.[58]

Asian financial crisis

When the booming stock markets of Asia tumbled in December 1997 and caused sharp drops in markets around the world, the global financial powers hastily put together a rescue package, amounting in the case of South Korea to $57 billion. Did the global lenders persuade the government to punish the corrupt politicians behind the crisis and to give more freedom and justice to the workers? Of course not.

Two former dictators or "presidents" guilty of massacres and corruption[59] were pardoned in a move said to be "aimed at uniting the country politically" as it faced "grave economic woes." Amnesty had already been granted in September to their partners in crime, the heads of seven giant conglomerates convicted of bribery or embezzlement, and 14 executives from Hyundai, separately convicted for embezzlement connected to presidential politics. The official reason was "to raise the morale of businessmen as a whole."[60]

The IMF and the World Bank, as well as the Asian Development Bank and the G-7 countries, rushed to provide a $10 billion first installment on the $57 billion bailout, and, as always, there were strings to the deal. South Korea agreed to give foreign corporations more access to its domestic market, open its bond market, and speed up the opening of branch offices by foreign banks and stock companies. What about the workers? President-elect Kim Dae-jung declared: "Companies must freeze or slash wages. If that proves not enough, layoffs will be inevitable."[61] The enormous leverage of the IMF over democratic institutions in borrowing countries was made plain in South Korea's presidential elections, as the Fund insisted that all presidential candidates endorse the IMF bailout agreement.[62]

U.S. exports to developing countries

The IMF and the World Bank celebrated their 50th anniversaries in the summer of 1994. They were credited by the U.S. Treasury Department with stimulating growth in developing regions that increased the demand for imports from the U.S. by $5 billion a year, thereby creating 100,000 jobs in the U.S., but the Treasury refused to reveal its methods for arriving at those figures.

The Institute for Policy Studies concluded, on the other hand, that these institutions have cost U.S. workers 20,000 jobs per year, while the loan recipients' development was hindered by the requirements that the IMF and World Bank imposed upon them. The growth rate of U.S. exports to the countries involved fell, on average, from 8.1% in the years before the loans, to 6.2% after loans, according to the IPS. Of the 54 nations that received high conditionality loans, 33 decreased their imports from the US.

The IPS explained that reducing tariffs and imposing requirements to purchase U.S. goods and services boost U.S. exports, of course, but these measures are outweighed by other policies. First, a country must devalue its currency, which makes imports more expensive. Second, it must reduce government spending, and third, it must eliminate government subsidies on domestic necessities, both of which cut consumption. Finally, countries are required to privatize publicly-owned corporations—resulting in the loss of many jobs, and further harming consumption levels.[63]

Part Five: Corporations Rule the World

28. THE CORPORATE NEW ORDER

After our examination of how the international banks are shaping the world, it would seem that they are becoming the new rulers. They share power, however, with the major corporations. In fact, the bankers and the heads of corporations sit on each other's boards of directors. Does the economic globalization they are implementing truly represent progress for everyone?

The apex of the pyramid

As described by Korten, three major forums have served to bring together key individuals from government, business, the media, and academia to create a consensus for economic globalization: the Council on Foreign Relations, the Bilderberg, and the Trilateral Commission. All three groups are secretive in the sense that heads of competing corporations and leaders of competing national political parties gather for closed-door discussions that the public never sees.

The Council on Foreign Relations was formed by a small elite group of foreign policy planners who were among those concerned about avoiding a recurrence of the Great Depression of the 1930s. They rejected any solution involving major reforms of the U.S. economy and strong governmental intervention in the market. They preferred steps to ensure American access to foreign markets and raw materials permitting continuous expansion as needed for full employment without market reforms.

The Bilderberg, named for the hotel where the first meeting was held in 1954, is less known and has no acknowledged membership, although participants include North American and European "heads of state, other leading politicians, key industrialists and financiers, and an assortment of intellectuals, trade unionists, diplomats, and influential representatives of the press with demonstrated sympathy for establishment views."

The Trilateral Commission was created in 1973, following discussions at Bilderberg meetings, to include Japan as it became an economic power. It was formed by David Rockefeller, chairman of the Chase Manhattan Bank, and Zbigniew Brzezinski, who was the Commission's director until he became national security advisor to President Jimmy Carter. Its membership of about 325 prominent people from North America, Europe, and Japan "include the heads of four of the world's five largest nonbanking transnational corporations...top officials of five of the world's six largest international banks...and heads of the major media organizations....U.S. Presidents Jimmy Carter, George Bush, and Bill Clinton were all members of the Trilateral Commission."

Korten wrote: "Publications of the Trilateral Commission...all accept without question the ideological premises of corporate libertarianism....In the absence of an elected international parliament, a call to harmonize standards is a call to take decisions...out of the hands of democratically elected national legislative bodies and pass them to the unelected bureaucrats who represent governments in international negotiations....

"The fact that George Bush and Bill Clinton were both members of the Trilateral Commission makes it easy to understand why there was such a seamless transition from the Republican Bush administration to the Democratic Clinton administration with regard to the U.S. commitment to pass the NAFTA and GATT....On this most fundamental of issues, the electoral system gave the voters only the illusion of choice...."[1]

Domination by corporations

Major players in the structural adjustments mandated by the World Bank and the IMF for nations receiving aid are huge multinational corporations. Do people who decry Communist planned economies realize the control large corporations maintain over their managers, employees, subcontractors, affiliated companies, and the communities in which they operate? They rival the central planners of the late Soviet Union, whose GNP in 1988 was about the same as total sales of the world's five largest diversified service companies in 1991. The world's ten largest

corporations had more revenue than the combined GNP of 100 nations. Although the 500 largest industrial corporations employed only one twentieth of a percent of the world's population, they controlled 25% of the world's economic output.[2]

Global corporations, being more powerful than most governments, routinely sidestep governmental restrictions. For example, when economic sanctions were imposed on Libya in 1986, the Houston engineering firm, Brown & Root, Inc., simply shifted a $100 million contract with Libya to its British subsidiary.[3]

The dominant elements of the world economy are foreign direct investment by multinational corporations and trade within and between firms. Two-thirds of the world trade in goods and services is done by 40,000 multinational parent firms and their nearly 200,000 foreign affiliates, according to the United Nations Conference on Trade and Development (UNCTAD) World Investment Report 1995.[4]

These global corporations and their allies control the global propaganda machine that tells people the road to happiness is through limitless shopping, that capitalism is another name for democracy, that all problems are caused by government restrictions on business and government social expenditures, and that ever-expanding global corporations are both inevitable and desirable.

Korten described the global new order in a 1996 magazine interview: "The dominant governance system [on the planet] is the financial system....Mutual funds, pensions funds and trust funds have become much more dominant investment vehicles...run by fund managers who are evaluated on the basis of very short-term results....In a globalized system, where corporations are able to free themselves to a large extent from local regulation and any sense of community membership, they are increasingly accountable only to that global financial system....

"As you erase national economic borders...the real competition is far less among firms—which are managing competition among themselves with mergers and acquisitions and strategic alliances. The real competition is among people and communities for a declining pool of jobs, and they compete by

offering the lowest wages, the poorest working conditions and the least environmental restraint....

"Corporations are putting enormous amounts of their money into buying politicians and rewriting legislation to serve their particular interests, to weaken environmental regulations, to weaken unions, to avoid any increases in minimum wages and to push through the trade agreements, which are really corporate bills of rights....

"The traditional dynamic of colonialism...was about getting a small group of people in the colonizing countries access to a large pool of wealth to support lifestyles that could not be supported purely on local resources. Globalization, and the ascension of corporate power, is an extension of that colonial process...."[5]

Consequences ignored in corporate finance

Korten noted increases in cancer, respiratory illnesses, stress, cardiovascular disorders, birth defects, and falling sperm counts, all linked by a growing body of evidence to such industrial by-products as air and water pollution, harmful chemicals in food, high noise levels, and electromagnetic radiation.[6] These negative "externalities" are outside the corporate balance sheet and ignored by propagandists for development who argue for government subsidies while fighting against health, safety and pollution controls. When public interest groups urge controls over the harmful results of growth, they are accused of blocking job creation.

Large public subsidies are often provided to corporations to stimulate economic growth, while detrimental effects are ignored. In the United States, for example, mining rights on federal lands are sold at bargain rates while "depletion allowances" give miners special tax breaks. In the Benguet province of the Philippines mining companies have stripped away trees and topsoil and poisoned the streams with cyanide but pay taxes amounting to less than one-half percent of their earnings.

The restructuring favored by the World Bank and the IMF causes people in developing countries to leave their traditional farming villages for work in export industries in the cities. One

result is that child care, health care, food preparation, entertainment, and physical security become increasingly part of the market economy, along with more tax collectors, managers, government regulators, accountants, lawyers, stockbrokers, bankers, middlemen, etc. The statistics of national production count all these expenditures as additions to economic output although they often are less efficient than the previous ways of meeting such needs.[7]

Can corporations can behave like good citizens?

"Few trends could so thoroughly undermine the very foundations of our society as the acceptance by corporate officials of a social responsibility other than to make as much money for their shareholders as possible."—Milton Friedman, *Capitalism and Freedom.*[8]

Friedman's belief that corporations should single-mindedly seek maximum profits without concern for the effects on society did not lead him to support government efforts for amelioration of the corporations' harmful social consequences. Such good corporate citizenship as has existed in the past has been almost exterminated by modern pressures of competition in the world marketplace. Because financial institutions compete for short-term investment profits, CEOs are forced to play this game. A corporation head who tries to build the long-term strength of the company with loyal employees is likely to be replaced by an opportunist who can inflate the stock price.

The public is often exhorted by the media to use its buying power to influence corporate behavior. The corporations laugh because individuals seldom know whether fish was caught by destructive trawler nets, or whether meat is from mistreated animals such as "battery chickens" or from cattle fed on infected sheep entrails (as in Britain's "mad cow" disease), or whether products have been made by children, underpaid workers and political prisoners. In fact, the government even prohibits labeling that would tell us whether the cows that supply our milk have been injected with artificial hormones, an instance in which lobbying by the Monsanto Corporation was more effective than farmers and consumer protection groups.[9]

It is usually assumed, as in the quotation from Friedman, that each corporation is run for the benefit of its shareholders—presumably all of them. After all, don't the stockholders control the corporation? That is more theory than fact. Usually the power of the corporation is in the hands of a few large stockholders, including the top executives—the ones who get stock options and golden parachutes when there is a buy-out. The other stockholders are virtually powerless.

On the few matters where a stockholder vote is required, the shares voted by executives and directors are usually joined by those of institutions such as mutual funds, pension plans, etc. The many people whose money is in the funds don't get to make any decisions. Their shares are voted by the institutions' managers, who are part of the network of interlocking directorates that rules the world of major corporations. One hand washes another.

This becomes clear when reformers who own some shares try to challenge arrogant management practices at corporate annual meetings. Sometimes they get considerable media attention, but almost invariably are voted down by shares supporting management. That was the fate of dissident shareholders led by the Rev. Christopher Hall of the Ecumenical Council for Corporate Responsibility at the Royal Dutch-Shell annual meeting in London on May 14, 1997, who lost by a margin of about 8 to 1. They called for outside auditors to check on the company's stated policies regarding environmental and social issues.

Shell, which is one of the 25 largest multinational corporations in the world, had been under attack for trying to dump an old 400-foot oil platform into the ocean west of Scotland in 1995 and for disregard of human rights in Nigeria.[10] The company was cited as one of 1995's ten worst corporations in a *Multinational Monitor* article for profiting off 500,000 Ogoni people and polluting their homeland, having spilled an estimated 1.6 million gallons in 27 incidents from 1982 to 1992 in its Nigerian operations, according to critics who were hanged by Nigeria's military dictatorship.

The article stated: "After soldiers opened fire on a peaceful demonstration against a contractor laying Shell pipes on

Ogoni farm land in April 1993—killing one person and wounding 10—the general manager of Shell's Nigeria subsidiary wrote the Governor of Rivers State...asking for more pipeline security." The nine dissidents hanged in November 1995 for opposing Shell and its government allies included playwright and environmentalist Ken Saro-Wiwa.[11]

Stockholders often have no more success when they are merely trying to protect their own financial interests than they do when they challenge the company's environmental and human rights policies. An example was reported on Feb. 23, 1996, in the *High Point Enterprise* at the major furniture center of High Point, North Carolina. A large showroom building, the International Home Furnishings Center, is owned by six majority stockholders owning 95% of the shares and 23 others whose 5% helped finance the start of the project. As it happens, the *Enterprise* and its publisher are two of the six majority shareholders, but the paper printed a balanced account of the dispute.

The minority investors disputed the price of $225 per share offered by the majority to buy them out. Although the shareholders paid for a study by the New York investment bankers, Dillon, Read & Co., on which the $225 price was based, minority shareholders had been unable to look at it. The president and CEO, Bruce Miller, arrogantly declared: "Everything that the minority shareholders were supposed to get, they got. They have everything they need to evaluate whether the offer is fair or not."

This reminds me of situation involving a small company of which I have personal knowledge. The president had been drawing salary and expenses, but there had been no dividends for several years to either the preferred or the common stock. The time was approaching when the preferred shareholders would take over the company because their promised dividends were in default beyond the specified time.

To forestall this, a meeting was called to approve a mandatory exchange of preferred stock for common stock (which had dubious value in a company with negative earnings). During the meeting a holder of preferred stock put several questions to the company lawyer, who was sitting next to the president and CEO,

about the effect on preferred stockholders who might not want to accept the worthless common stock.

When this attorney, hired with the stockholders' money, refused to answer questions and declared he was supposed to serve only the officers and directors, the weak position of any stockholders not possessing a majority of the voting shares was clearly demonstrated. Of course, they could have gone to court, but it would have been at their own expense while management was using attorneys paid by corporate funds. Not enough money was at stake to make this worth pursuing, so their interests that were supposedly protected by the terms of the preferred stock were just wiped out.

Although management and its interlocking directorates have long been able to ignore most complaints from ordinary stockholders and employees, they occasionally were hauled into court for improper and fraudulent actions. To protect them, as well as their accountants and other consultants, industry successfully lobbied for the Private Securities Litigation Reform Act of 1995 (yet another misuse of the word "reform"), which Congress passed over President Clinton's veto. Now it has become even more difficult to sue corporate management in federal courts for defrauding investors.

29. A LEGAL FICTION THAT HURTS

You might think that the Constitutional protection of freedom of speech refers to human beings—after all, who else (except perhaps talking parrots and chimps using sign language) is capable of speech? If you are a judge you may hold otherwise, however, because the courts observe the "legal fiction" that a corporation is a person. As a result the rights of corporations are stronger than the rights of individuals. Corporations now have the basic rights given to individuals by the Constitution, including freedom of speech, in addition to their special rights of limited liability and perpetual life. Although corporations lack the vote, they are effective in "buying" votes. The officials individuals elect listen to them much less than they listen to the corporations and lobbyists who supply funds and favors.

We all learned in school that the corporation is a useful form of business organization, and that is true. Bank loans and outside investments are more available to a perpetual entity than to proprietors whose mortality poses a risk, and investors will more readily accept some risk when their liability is limited. We may not have learned in school how this institution was invented. It was devised to overcome a barrier to commerce. In the 16th century, not only were there debtors' prisons but also debt was inherited. Beyond the perils of the sea, a venturer to the new world risked ruin of his family for generations.

Corporate charters were issued by the monarchy, contained specific rights and obligations, and could be withdrawn anytime. As instruments of the crown many corporations were granted monopoly powers, as in the case of the East India Company and Hudson's Bay Company, as well as many American colonies themselves.

Colonists could import goods and export certain products only through England, being restricted in the ships and crews they could use, and were forbidden to produce certain clothing and iron goods. Adam Smith condemned such practices in *The Wealth of Nations* in 1776: "It is to prevent reduction of price...by restraining

free competition...that all corporations, and the greater part of corporation laws, have been established."

After the American Revolution, which was fought against these abuses as well as others, the states were careful about issuing corporate charters, limiting them to specific purposes and to a fixed number of years unless renewed, with interlocking directorates outlawed, and charters subject to withdrawal by state legislatures if they failed to serve the public interest.

Since the 19th century U.S. corporations have been using the courts to change the rules to suit their interests. President Abraham Lincoln observed just before his death: "Corporations have been enthroned....An era of corruption in high places will follow and the money power will endeavor to prolong its reign by working on the prejudices of the people...until wealth is aggregated in a few hands...and the Republic is destroyed."[12] Even President Rutherford B. Hayes, declared: "This...is a government of corporations, by corporations, and for corporations."[13] As state legislatures, especially in Delaware, courted corporations by limiting the liability of corporate owners and managers and issuing charters in perpetuity, corporations managed to avoid the limits originally imposed by states.[14]

Finally, in an 1886 case involving the Southern Pacific Railroad, the U.S. Supreme Court gave corporations virtual *carte blanche*, ruling that a private corporation is a natural person entitled to free speech and other constitutional protections extended to individuals under the U. S. Constitution.[15]

Although the Constitution makes no mention of corporations, they thus obtained the rights enjoyed by individual citizens without many of the responsibilities and liabilities of citizenship. They claim the same right as any individual to influence the government in their own interest—making a rather uneven contest. Because of secrecy, we know only in part what corporate money is going into supposedly grassroots organizations and controlling them.[16]

How the corporations get their way

Although corporations can't vote, they do influence elections, and one would have to be quite naive to doubt that their

support gets rewarded. For example, during the 1994 campaign candidate Newt Gingrich and Senator Robert Dole, along with Republican party chairman Barbour, toured the country raising extra funds from wealthy executives in a way that smacks of extortion, implying dire consequences in a Republican congress for those who didn't ante up. They took large donations as "soft money" to exploit a loophole in the campaign finance laws.

Amway Corporation gave $2,500,000 and received favors from Senator Dole involving telecommunications industry deregulation. Its opposition to food and drug regulation also got support from Gingrich's tax-exempt foundation which called for abolition of the FDA. Senate investigators found that millions of dollars were given during the 1996 congressional elections to nonprofit groups that aired television ads supporting conservative candidates. Since they aren't required to disclose their donors, it is not clear how much corporate money was involved.[17]

Constantly reminding politicians of favors and seeking favorable action, companies, associations, and other special interests maintained 14,484 lobbyists in Washington and spent $1.17 billion in 1997, according to a computerized study of lobbying disclosure reports by the Associated Press and the Center for Responsive Politics.[18] The top spender was the American Medical Association, $17,100,000; second, Philip Morris, $15,800,000 (the tobacco industry total was $31,650,000); third, Bell Atlantic, $14,300,000 (the telecommunications industry total was $63,960,000); fourth, the U.S. Chamber of Commerce, $14,200,000 (the business groups total was $24,600,000); and fifth, Pfizer, $10,000,000 (the pharmaceutical industry total was $59,700,000).

Among other industries were oil and gas $51,700,000, defense $40,000,000, automotive $34,600,000, and computers $12,000,000. The Commonwealth of the Northern Mariana Islands, which exports clothing as "Made in USA" from factories that hire foreign garment workers at less than the federal minimum wage, spent $2,000,000, using a former cabinet member, two former senate majority leaders, and two former governors as lobbyists.

It should be noted that these expenditures do not include political contributions to the candidates, to their parties, and to propaganda organizations that aid one candidate or party against another. The top spenders would undoubtedly include some other interests during different time periods. For example, the tobacco industry spent more than $58 million on lobbying in two years (1996 and 1997), while also contributing over $14 million since 1995 to candidates and political parties at the national level. Philip Morris alone spent over $12 million to lobby the federal government in the first six months of 1996.

Tobacco settlement to bail out industry

In response to civil suits by attorneys-general of numerous states for damages, the tobacco companies negotiated settlements dependent upon Congressional action. The states claimed huge amounts for medical expense for treating smokers because the companies marketed cigarettes after allegedly knowing that tobacco was addictive and caused cancer. At the trial of the Minnesota lawsuit against the tobacco industry early in 1998 the state introduced some of the millions of documents it had collected. They contradicted the many denials by company executives that tobacco is addictive, some made under oath by CEOs of the major firms in Congressional testimony:

A 1972 memo by R. J. Reynolds researcher Claude Teague included the remark: “Happily for the tobacco industry, nicotine is both habituating and unique in its variety of physiological actions.”

A 1978 Brown & Williamson memo signed H. D. Steele noted: “Very few consumers are aware of the effects of nicotine, i.e., its addictive nature and that nicotine is a poison.”

A 1983 memo by B&W researcher A. J. Mellman stated: “Nicotine is the addicting agent in cigarettes.”

An undated marketing document by British-American Tobacco product development researcher Colin Grieg referred to cigarettes as a low-cost “drug administration system for public use” and noted that “other ‘drugs’ such as marijuana, amphetamines and alcohol are slower and may be mood dependent.”[19]

Despite this, Washington politicians in the White House and on Capitol Hill were aiming to pass a bill in 1998 ratifying state legal settlements that would curtail rights of past and future victims to sue for damages. The tobacco companies who insisted on this immunity were among the biggest contributors to political campaigns on the federal level. When the bill, as amended, was not to their liking, they spent $40,000,000 on a media campaign to denounce it as a tax on the poor and working class, and the bill was killed.

Big Business can do business with Big Government

As President Clinton joined with Republicans to call for the end of big government, too little attention was given to the fact that most of the political attacks on big government had been financed by major stockholders and top management of big business, which has bureaucratic inefficiency on the same scale as big government. Nobody said much about big business, nor realized that if corporations weren't so big, we wouldn't need so much big government to control them and fix the problems they create.

Flouting the laws

While the owners of businesses and corporate management would like to be above the law, with the immunity enjoyed by major league baseball, they sometimes approach the same result by ignoring laws they don't expect will be enforced. It may cost them an occasional minor fine or slap on the wrist, considerable legal expense, contributions to the politicians who can help them, and sometimes sacrificing an underling to protect the big bosses, but many of them prefer it to obeying the law.

Such behavior is seen among persistent polluters, safety law violators, child labor exploiters, labor relations scofflaws, and violators of the antitrust laws. It is, of course, patterned on methods used by gangsters and drug lords to resist the law.

The problem involves multinational corporations more powerful than many nations. Their records on human rights are generally dismal, and they have been responsible for much of the

exporting of American jobs to exploited workers in low-wage countries.

30. MONOPOLY AND RESTRAINT OF TRADE

Heads of corporations announcing a merger often speak of enabling their companies to compete more effectively and to improve their service to customers. Actually the opposite is usually the case—mergers are a means of suppressing competition, and service to customers generally deteriorates as fewer companies are competing for their patronage. Adam Smith, the 18th century free-market economist whom business leaders revere, said: "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices."[20] Smith knew that the "invisible hand" of supply and demand in the market cannot do its magic unless there are many buyers and many sellers.

As ever-larger mergers continue to be announced, the beginning of the 21st Century may resemble the turn of the century 100 years ago. About that time the "robber barons" of industry, as they have been called by reformers and some historians, were riding high. Vanderbilt, Rockefeller, J. P. Morgan, and other "captains of industry" did not build their fortunes by fair business dealing as most people would regard it today. In fact, much of the federal regulation that exists now was enacted to prevent a repetition of their coercive business practices.

Emergence of the railroads

During the 19th century, railroad promoters, including Cornelius Vanderbilt and others, received vast gifts of public land to encourage them to build lines across and throughout the U.S. (which land, incidentally, was later spun off into separate corporations for profitable real estate development, while passenger rail operations were neglected). The lords of the rails set high and discriminatory rates for freight and passengers over those routes where no alternative transportation was available,

eventually leading to creation of the Interstate Commerce Commission (ICC) in 1887, after state legislation had been invalidated by the U.S. Supreme Court.

Not satisfied with the profits to be obtained from this new form of transportation, the railroad magnates further lined their pockets by stock manipulation, which was subject to little regulation until the Securities and Exchange Commission (SEC) was created in 1934. The majority of state legislators in the 19th century were said to be on the payroll of the railroads. (I was interested to learn that Abraham Lincoln, before he was elected President, was a railroad lawyer with a fine home quite unlike the log cabin in which the "rail-splitter" was said to have grown up.) With the political control the railroads had at the state level, it is understandable why they fought against federal regulation by the ICC. They welcomed free land from the federal government, but not federal regulation.

Birth of the oil cartel

John D. Rockefeller also amassed his fortune in the 19th century. It came from petroleum, but he used conspiracy with railroads to build his Standard Oil empire. With promises and threats he got railroads to charge his competitors in the oil business higher freight rates than they charged his company. By this means, and other sharp practices, he acquired competitors or drove them out of business.

The Standard Oil monopoly was a major impetus for the Sherman Antitrust Act of 1890, but the law was weakened by court interpretations and languished for a decade, failing to prevent the growth of more monopolies. When Theodore Roosevelt launched his famous "trust-busting" effort in 1902, his attorney general first took aim at a railroad holding company, Northern Securities, and prevailed in the Supreme Court.

The dissolution of the Standard Oil empire under the Sherman Act was upheld by the Supreme Court in 1911. The ostensibly independent pieces that resulted (Standard Oil Companies of New Jersey, New York, Ohio, California, etc.) have seemed quite competitive with each other at times, but also have

been found to have conspired together against consumers, notably during the OPEC oil crises of 1973 and 1979.

J. P. Morgan and U.S. Steel

Formation of a monopoly in the steel industry was engineered by the powerful financier, J. Pierpont Morgan, in 1901 with formation of U.S. Steel Corporation, for many years the largest holding company in the nation, capitalized at $1.4 billion. An antitrust case was brought against U.S. Steel by President Taft's administration in 1911, but the Supreme Court finally ruled in 1920 that, although the company clearly possessed monopoly power, it did not "unreasonably" restrain trade.

The concentration of power in the steel industry has been blamed for loss of world markets as steel companies in other nations modernized their plants, while the U.S. steel industry complacently milked the tariff-protected domestic market until foreign steel flooded in over the weakened trade barriers.

Arguments for bigness

The argument that size makes a firm more competitive is legitimate only to a point. "Economies of scale" obviously improve efficiency as the result of division of labor and specialization. Often this is interpreted as "the bigger the better." However, large units are not always more efficient. So long as a business grows because of good management and success in pleasing its customers few people would object. Its size would be limited by the optimum for efficiency, and, of course, by the success of its competitors. Bigness is therefore not bad *per se*, but when growth is sought by swallowing up or destroying competitors, the public is not benefited, nor is efficiency assured. By the decade of the 1990s most well-known businesses probably exceeded their optimal economic size.

This also applies in agriculture, where a 1979 study by the U.S. Department of Agriculture found that the average U.S. farm reaches 90% of maximum efficiency at just 314 acres, and 100% efficiency at 1,157 acres. Beyond that, farms don't get any better.

They may become more bureaucratic and less efficient. The very largest farms are twice as debt-prone as smaller family farms.[21]

Many studies have shown that relatively small companies produce more innovation, new products, and new jobs than the giant corporations. For example, Florida and Kenney (1990) found that "venture capital-backed start-ups dominate the top 100 research and development spenders in microelectronics, as measured by percentage of sales invested in R&D....Contrary to conventional wisdom, most high-technology start-ups are not creatures of the Pentagon. In fact...most are quite hesitant to accept defense funding for R&D." They quoted National Science Foundation statistics showing that small companies (with 50 employees or less) increased their share of total corporate R&D spending from 6% in 1980 to 12% in 1987.[22]

New jobs also arise predominantly in smaller companies, as has been recognized in their speeches by political candidates of both parties, while "downsizing" has become the favored route to profit enhancement in the giant corporations. Of course, even when a company has grown beyond its optimum size, domination of its market may give it the power to increase its profits. That is not efficiency in any legitimate economic sense of the word because the corporate gains come at the expense of its customers, and perhaps its employees.

The motivation for mergers and acquisitions, therefore, is more often a desire for market control than efficiency. Another motive, of course, has been the opportunity for windfalls to top management as well as wall street lawyers and investment bankers.

Renewed monopoly building in the late 20th century

A hundred years ago the public recognized such dangers as the Standard Oil monopoly, U. S. Steel, and other pools, trusts, and cartels in commodities and transportation, which led to the Sherman Antitrust Act of 1890. As loopholes were revealed, Congress passed the Federal Trade Commission and Clayton Antitrust Acts of 1914, followed by the Robinson-Patman Act of

1936 that outlawed price discrimination tending to destroy competition.

Corporate lawyers kept trying to find escape hatches, but federal action occurred often enough to restrain merger mania until the 1980s. The restraints collapsed under President Reagan, whose habit, whenever he didn't approve of a law, was to appoint people hostile to the laws they were supposed to enforce. The proportion of all industrial assets controlled by the top 100 corporations had grown from 39.8% in 1950 to 46.4% in 1960, 52.3% in 1970, and 55% in 1980. By 1983, 58.2% of those assets were controlled by the top 100, and 13% were controlled by only five companies: Exxon, General Motors, IBM, Mobil, and Texaco. Most of this concentration resulted from smaller companies being bought up or merged into larger ones.[23]

The wave of corporate mergers, takeovers, and restructuring during the Reagan years amounted to more than 25,000 deals, cumulatively valued at more than two *trillion* dollars. Hundreds of major companies were subjected to leveraged buyout, merger or acquisition. Between 1984 and 1987 alone, there were 21 such deals for a billion or more dollars each.[24] Most mergers are tantamount to acquisitions, the difference being a legal technicality when management of one company dominates the other after the merger.

Walter Adams, Professor of Economics at Trinity University, Texas, and past president of Michigan State University, in an interview published by *Multinational Monitor* in June 1996, cited the example of department stores. "A real estate operator out of Montreal, Campeau, acquired a whole bushload of department stores—great names like Bloomingdale's Burdine's, Lazarus, Jordan Marsh—that ended in bankruptcy.

"Other bankruptcies in the industry include: B. Altman, Garfinkel's, Carter Hawley Hale, Macy's, Ames. These mergers were financed with debt that has burdened the companies so that they could not do the things they ought to have done to enhance production efficiency, technological progressiveness and international competitiveness."

Also interviewed in the same article, James Brock, Professor of Business and Economics at Miami University (Ohio),

pointed out: "The purpose of deregulation is to have competition do the regulating, but if you...let all the major firms merge...then they destroy the basis for that competition....Section 7 of the Clayton Act prohibits mergers that might substantially lessen competition or tend to create a monopoly. It does not say anything about efficiency....

"After World War II, when the US occupied Japan, we implemented a massive trust-busting program to break up the monopoly of financial and economic control that existed there. We...created an intensely competitive system. They were competitive at home, and...therefore [in] global competition....

"Study after study of the sources of inventions...shows it tends to be mavericks, independents or outsiders. They tend not to have much money to work with....The notion of economics today has been twisted...to represent one narrow, extreme ideological point of view, the *laissez-faire* point of view...."

Changes in the merger movement

Mergers and acquisitions in the 1970s emphasized conglomerates. That is, combinations were formed of companies that were not in the same industry and therefore a merger was less likely to be considered damaging to competition. "Synergy" was a popular word, denoting that the combining companies added up to more than the sum of their parts because of ways they could help each other.

This changed in the 1980s as supporters of *laissez-faire* economic policies were appointed to antitrust enforcement posts. The results showed up, to my surprise and chagrin, in a computer model I developed to predict the likelihood that a company would be acquired (as an indication that the price of its stock would be bid up). This was an outgrowth of research on acquisitions that I did as a doctoral candidate.

The doctoral research aimed to measure the factors that influence how soon a company becomes acquired. It showed that among firms acquired from 1972 through 1976, acquisition tended to come sooner when: (1) managerial economies were available as indicated by lower profitability (before interest and taxes) than the

weighted average of its industry; (2) potential increase in stock value was indicated by lower price-earnings ratio than industry average; and (3) there had been an increase in earnings before interest and taxes (EBIT) over the previous three years.

Statistical measures showed significance of the model as a whole to be well above the 99% confidence level. When the model was tested to see how well it would have predicted results in the next two years, 1977 and 1978, the error was about as small as that of the original sample.

An adaptation of this academic model, eliminating industrial categories where there were no acquisitions in recent years (presumably because of industry concentration that would arouse antitrust concern), was able to select stocks for each of the seven years 1977-83 that gained an average of 31.4% each year, not counting dividends, compared with 7.3% for the Standard & Poor's 500 Stock Index.

When the same formula was used to select stocks for purchase at the beginning of 1984, however, their performance by year-end was only about a break-even result. This was not just because Standard & Poor's 500-stock index ended the year with only a tenth of a point gain; there were years of decline in the earlier period when the model was successful. In my opinion, it was due to the change of behavior in the merger market. As the promoters of mergers and acquisitions developed confidence that antitrust administrators would look the other way, they changed their criteria for selecting targets, emphasizing opportunities to enhance profits by eliminating competition.

Merger failures

Often gains in stock prices in connection with mergers are temporary as the promised benefits fail to materialize. James Brock, an economics professor at Miami University of Ohio, was quoted by the Associated Press in October 1997: "At some point the size of the organization becomes so complex, so complicated, that it is increasingly difficult to manage and orchestrate." He added that every merger boom since the 1890s produced only a

minority of companies that actually improved their operations after takeovers.

The AP report concerned the problems of Aetna, which revealed disappointing profits after its $8.9 billion purchase of U.S. Healthcare; Union Pacific, planning to abandon business to competitors because of routing, computer, and labor problems from its $5.4 billion merger with Southern Pacific; and Wells Fargo, which had to pay back depositors for money put into wrong accounts by computer mix-ups after its $14.2 billion combination with First Interstate.[25]

The opposite of a merger is a spin-off, and insiders make huge profits from both. Many bloated conglomerates have sold off one or more divisions to the public, to speculators, or to groups of their own management people.

Mergers continue in the 1990s

In the 1990s mergers continued almost unabated under President Clinton, with a new record of 3,700 merger filings in fiscal 1997.[26] Occasionally the antitrust division of the Justice Department showed some signs of life, as in its 1998 successful prosecution of Archer Daniels Midland Co. (ADM) and three of its top executives for illegally conspiring with four Asian companies in price-fixing (the company pleaded guilty and paid $100 million in fines, while the individuals face up to three years in prison and millions of dollars in fines).[27] The government also took on Bill Gates' Microsoft Corporation, charging that it was illegally using its dominance of desk-top computer operating systems to give its other software unfair advantages over competitors. For the most part, though, the trend for government to let big companies buy out or stifle competition continued.

As the Senate Judiciary Committee held hearings in June 1998 on the multi-billion-dollar mergers of banks and other industries, FRB Chairman Alan Greenspan warned Congress against interfering. Although Joel Klein, head of the Justice Department's antitrust division assured the committee his agency was "carefully considering" the impact on competition and consumers, Federal Trade Commission Chairman Robert Pitofsky

declared: "We believe that many of these mergers are the result of fundamental economic changes in both our economy and world markets and that they are, for the most part, beneficial to the economy and to consumers."[28]

Huge banking chains merged together, and their announcements took government approval for granted. Television and radio giants gobbled up more stations, with the help of the FCC (and in 1996 the Telecommunications Act), and further combined with entertainment, cable, and publishing companies.

Stores that used to compete with each other were bought up by chains, reducing consumer choices. Manufacturers actually bought shelf space in supermarkets to crowd out alternative brands. They formed combinations so rapidly it is hard for any consumer dealing with a business to know who owns it. Grocery products of Kraft and General Foods, as well as Miller beer, came from the same parent company as Philip Morris cigarettes. The many products of Nabisco were part of the R. J. Reynolds tobacco giant. One shopping mall came to look very much like another with stores that belong to chains that in turn belong to huge corporations.

The same was true in fast food where, for example, Pizza Hut and Kentucky Fried Chicken belonged to Pepsico Restaurants International, and in the communications business, where restraint of trade is particularly dangerous because it leads to restraint of information.

Even the professional auditing firms that examine the accounts of corporations have been merging. In October 1997 mergers were proposed that would result in the auditing of most major corporations of the nation and the world being done by only four giant firms, down from the current Big Six, which were the Big Eight when I worked for one of them in the 1960s. These mergers, according to the Associated Press, "are a reflection of the changing focus in the industry into a one-stop service that combines the traditional auditing...with consulting." The danger here is that the firm doing an audit for the protection of stockholders and the public could lose its objectivity.

The 1990s wave of bank mergers and attempts to expand into the insurance and securities brokerage businesses was

discussed in the chapter on banking. The logical outcome of unrestricted monopoly building is a world in which people are forced to deal only with one monopoly bank/financial company, one monopoly store, and one monopoly source of information blanketing the airwaves and print media. This would be not unlike the monolith of the former Soviet communist regime, except for the rulers being a private elite controlling government from behind the scenes rather than in government posts.

Control of communications

The bipartisan Telecommunications Reform Act of 1996, for which both major parties engaged in an orgy of self-congratulation, effectively removed virtually all limits in the communications and entertainment industries. The acquisitions of ABC by Disney, CBS by Westinghouse, and NBC by General Electric all occurred because the companies knew the bill would excuse them from antitrust and FCC restrictions. And, of course, laxity by the FCC in the 1980s had already allowed Rupert Murdoch's Australian company to exert foreign control of the Fox network and to exceed the previous 12-station limit.

After amassing empires in publishing and broadcasting in Australia and in England, Murdoch turned to the U.S., buying the New York *Post*, the *Village Voice*, *New York* magazine, the Boston *Herald*, the Chicago *Sun-Times*, the Twentieth Century Fox film studio, and Metromedia television stations. His papers tended to be sensational tabloids and he also pushed the limits of taste and decency on the air. Although Murdoch was quickly granted U.S. citizenship with VIP treatment to overcome objections about foreign ownership, he controls Fox through his Australian company, News Corporation, which also controls over 70% of the press in Australia, and over 35% in Britain.

Under the 1996 law, all the TV and radio stations and newspapers in any city can now be controlled by one monopolist, and television station owners are now allowed to control as much as 35% of the entire viewing market. As a deal was pending for purchase of 13 stations of Sullivan Broadcasting Holdings by Baltimore-based Sinclair Broadcasting, a news account in March

1998 reported that Sinclair would then control 55 TV stations, or 23% of the American market, having purchased 27 stations in the previous year.

Sinclair's purchase of the 13 Sullivan stations cost about a billion dollars, and Professor John Bittner of the University of North Carolina at Chapel Hill said many stations operate with profit margins in the 40% range. To raise profits and pay off acquisition debt some of the conglomerates shave payrolls, he added, "They feel they can go in and clean out the news operation and replace it with younger and cheaper talent as a way of servicing their debt."[29]

Time-Warner, which controls an unprecedented number of periodicals, books, films, TV programs, and cable TV systems, acquired Ted Turner's TV channels and film inventory. A German company, Bertelsmann AG, was reported in May 1998 to be acquiring the biggest U.S. book publisher, Random House, for over $1 billion, having already taken over Bantam Books, Doubleday, Dell-Delacorte and Broadway Books, the BMG music club, the RCA and Arista record labels, and McCall's and Family Circle magazines in the United States.[30]

The "Baby Bell" phone companies, separated from "Ma Bell" by a court antitrust decree, were allowed to recombine, and to enter the long-distance telephone business. The merger of Bell Atlantic and Nynex, valued at $22.7 billion, was second in size only to the $25 billion RJR Nabisco deal in 1989.[31]

Non-profit health services become private monopolies

Health maintenance organizations (HMOs), originally required to be non-profit, had convinced almost every state legislature by 1996 to allow HMOs to be organized for profit and in some cases to be converted from nonprofits.[32] Similarly, nonprofit hospitals were allowed to become profit-making by merger or acquisition. A Public Citizen report found that in 1995 there were 447 community hospitals involved in merger and acquisition activity (more than 900 if hospitals already part of chains are included)—almost one fifth of all community hospitals.[33]

Two hospital chains—Columbia/HCA Healthcare, the nation's largest for-profit hospital chain, and Tenet, ranked number two—had gained control of three-quarters of the for-profit market by 1994, and Columbia/HCA said that it planned to acquire as many as 500 more hospitals in the next few years. In 1995 it purchased or began joint ventures with 41 nonprofit hospitals.

In 1997 Columbia/HCA owned 340 hospitals in 36 states, England, and Switzerland. Founded in 1988 by Richard L. Scott, a former attorney, with only $125,000 of his own money and $61 million in borrowings, it grew from two hospitals in Texas to its present huge hospital empire, 147 outpatient surgery centers, approximately 550 home-health agencies, and a host of other medical facilities.

Columbia/HCA's methods have come into question in the biggest health-care fraud investigation ever conducted, involving Florida, Tennessee, Georgia, Texas, Utah, North Carolina, and Oklahoma. Meanwhile, a merger being negotiated with Tenet, the second largest chain, would produce a profit-making health-care combination with a $31.5 billion market value.

Tenet, then known as National Medical Enterprises, was the target of the previous largest health-care fraud investigation that was settled in 1994 for more than $380 million. Later, in July 1997, a Tenet unit agreed to pay the U.S. more than $12 million to resolve allegations that several of its hospitals defrauded Medicare through illegal contracts and kickbacks.[34]

The military-industrial complex

Consolidation of power is especially dangerous in the defense industry. Federal Trade Commission approval in 1997 of the $14 billion merger of McDonnell Douglas Corp. into Boeing Co. to form the largest aerospace company in the world left the Defense Department with only one bidder on military aircraft. Boeing was left with only two competitors for commercial airline sales throughout the world.[35]

In his farewell address to the nation in 1961, President Dwight D. Eisenhower had warned of "an immense military

establishment and a large arms industry" and urged an alert and knowledgeable citizenry to guard against "the acquisition of unwarranted influence...by the military-industrial complex," referring to the Defense Department, military contractors, and members of Congress who represent defense-oriented constituencies. Unfortunately, his warning has been as little heeded as George Washington's farewell warning against "entangling foreign alliances."[36]

Monopoly in the national pastime

An interesting special case of monopoly involves major league baseball. Periodically, as in 1994 when a baseball strike for the first time resulted in cancellation of the World Series, some fleeting attention is paid to the unique status of the national pastime. The legal immunity of the owners makes their situation stand out among all the organized professional sports. It also explains their arrogance in calling bckouts and refusing binding arbitration of labor disputes.

A fundamental error was made by the Supreme Court long ago. Chief Justice Oliver Wendell Holmes was speaking as a rooter rather than a jurist when he proclaimed baseball was not a business, just a game. He was wrong then, and the error is even clearer now when players' salaries and club franchises are multi-million-dollar affairs. Why should big league baseball club owners get special privileges not accorded to other profit-seeking businesses or even other professional sports?

The immunity of organized baseball from antitrust challenges has allowed the American and National Leagues to limit expansion and the owners to hold communities to ransom. To have a major league team they have been compelled to furnish expensive facilities at taxpayer expense. Owners want the new stadiums to have luxury suites or "sky-boxes" which typically sell for $80,000 to $200,000 a season to corporate executives who will use them for entertaining clients and associates as a tax-deductible expense.

During the 1994 strike bold statements were issued by Congressional leaders demanding legislation to remove baseball's

antitrust immunity. The law finally enacted and signed by the president on October 27, 1998, however, revokes antitrust exemption only for labor relations, not for relocation and expansion decisions, and appears to have little practical effect because of a 1996 Supreme Court ruling that unionized employees cannot file antitrust suits.[37]

World competition as an excuse for monopoly

When huge American-based companies seek permission to combine into even larger entities, their favorite excuse is that they need to merge in order to become more competitive in a world market where they are contending with other giant corporations. If the company is obtaining capital, arranging for production, and marketing its products on a global basis, however, it can no longer be factually described as an *American* company. It is multinational, having stockholders, creditors, employees, subsidiaries, sub-contractors, and customers in various countries.

As Korten pointed out, when Philip Morris acquired Kraft and General Foods, "as it did in the 1980s to create the U.S.'s largest food company, it does not make U.S. markets more competitive; it creates a strengthened platform from which to create and project monopoly power on a global scale....The bigger our corporations, the greater the need for big government to protect the public interest....The more we cut our giant corporations down to human scale, the more we will be able to reduce the size of big government...."[38]

Being more competitive, in the ideal capitalism of Adam Smith, results in better value to consumers. It doesn't always work that way in the modern world of multinational corporations. Price reductions and product enhancements may be temporary until a giant corporation drives smaller competitors out of the market. This process can continue until the few remaining global corporations agree to divide the market, geographically or otherwise, so that each has a monopoly in its sphere.

The trend can be seen by anyone browsing the shopping malls and observing several results:

1. The tenants of each mall are overwhelmingly the same as those of other malls. The anchor stores are chain department stores, the specialty shops are mostly members of chains that are represented in the other malls, and the same can be said generally of the fast food restaurants in the malls. “You’ve seen one mall, you’ve seen them all.”

2. To a considerable extent the same product lines are found in different stores. If you prefer a color or style that is not “trendy” at the moment, you are unlikely to find it by going from one store to another.

3. Prices have little to do with products’ intrinsic worth. Successful promotion of denim as fashion since the 1960s has made sturdy work clothes into expensive “designer” garments. Shoes made for a few pennies in sweatshops around the world are priced at $100 or more.

If we interpret “more competitive” in the sporting sense of American companies winning greater market share than those of other nations, the question arises: “How does America benefit if stockholders (of whatever nationality) in a U.S.-based global corporation prosper at the expense of American workers and consumers?”

Where a global corporation is based is almost irrelevant, since the great corporations have grown so large they tower over all but the largest nations and have learned to dominate the politics of even the mighty United States. Just as U.S. corporations found it to their advantage to be chartered in Delaware because of the permissive nature of its laws, and ships of whatever ownership tend to be chartered in Panama or Liberia for similar reasons, multinational corporations can choose their nominal nationality as a matter of convenience and play off one nation against another to the corporation’s commercial advantage.

When nations allow monopolistic practices, ostensibly to facilitate competition in global markets by their home-based companies, the eventual outcome is not competitive global free enterprise but global domination by mega-corporations that are powerful enough to form cartels, inflate prices, drive down wages, and dominate governments. It is appropriate for corporations to concentrate on profits and returns to their stockholders, but if that

effort is not under the restraint of fair competition and government regulation for public protection, the impact on humanity and the environment can be horrendous.

The ultimate monopoly

Although monopolies have been created by royal grants, by patents and copyrights, by public utility franchises, by broadcast licenses, and by market power that drives out competition, the foremost natural monopoly is land. When economists speak of land as a factor of production, they include all natural resources, such as "arable land, forests, mineral and oil deposits, and water resources" in the words of one textbook, "free gifts of nature usable in the productive process." In those countries where the populace is most down-trodden, the control of land by a few wealthy families is typically cited as a major cause.

The Single-Tax Movement, founded by Henry George and explained in his book, *Progress and Poverty*, became strong in the late 19th century and continues to exist today. It proposes to abolish all taxation other than upon land values, declaring that alone would provide all the revenue needed for government and could eliminate the other taxes that burden progress. George quoted David Ricardo: "A tax on rent would fall wholly on landlords, and could not be shifted to any class of consumers." That is because, as monopolists, land owners will charge all that the traffic will bear even without being taxed.

For justification, George pointed out that all ownership of land traces back to some time when it was taken by force. Apart from the shaky titles upon which private land ownership rests, George described at length how increases in prices of land, sometimes quite dramatic, occur as the result of population growth and the general progress of society, and not by any productive work of the land owners. In modern times prices of land are seen to jump sharply when land zoned for farming or low density residential use is rezoned to permit commercial development. Land owners obtain a windfall, and have been known to show their gratitude to public officials who change the rules for them.

In America it may seem enough land is available for this not to be a major problem. On the other hand, throughout the world, in Africa, in Asia, and along the Amazon in South America, multinational corporations have been busy acquiring land to exploit natural resources. In many cases, with the connivance of corrupt governments, indigenous peoples have been driven off their ancestral lands. Mining, oil drilling, and timber cutting have often had disastrous effects on local farming and fishing. Henry George may or may not have come up with the ultimate solution to this problem, but the problem has not gone away.

31. CHANGING VIEWS ABOUT THE BALANCE OF TRADE

Much concern about trade over the years, especially in newspaper editorials, has reflected worry about an "unfavorable balance of trade," meaning the nation imported more than it exported. This has been a cause for alarm as long as anyone can remember. Should it be? It depends on what has been bought, just as the significance of national debt, as previously discussed, depends on whether it has been used for investment (physical and human) or consumption. During the period of rapid industrial development in the United States there was much importing of machinery and tools that improved production capacity. The impact of a trade deficit also depends on how it has been financed. When the required foreign currency has been borrowed, it must someday be paid back, either through a surplus of exports or by selling assets, such as real estate, and too much foreign ownership of American property can be worrisome.

As America has reduced its tariffs and trade barriers under international agreements, exports of U.S. products to other countries have fallen far short of balancing the imports. According to William Greider (1997): "Cumulatively, since 1980, Americans have bought $1.5 trillion more than they sold in their merchandise trade with foreign nations. The trade deficits started modestly in 1975, exploded during the 1980s, and, despite ebbs and surges, set a dollar-volume record of $180 billion in 1995."[39]

In the 1990s shoppers found "Made in China" dominating many categories of merchandise, and other labels indicated imports from numerous low-wage countries in Asia and elsewhere. In 1997 imports from China alone were $62.6 billion, having more than doubled in five years, and far surpassed the nearly $13 billion U.S. exports to China. This flood of imports was on top of heavy reliance on foreign oil. The foreign-origin percentage of goods other than oil sold in the U.S. had grown, according to David Korten, from 15% at the beginning of the 1980s to 30% in 1995.[40]

Free trade favored by economists

Probably more economists agree on the issue of free trade than any other question. In principle, it is an extension of the division of labor. Adam Smith wrote in 1776: "The tailor does not attempt to make his own shoes but buys them of the shoemaker. The shoemaker does not attempt to make his own clothes but employs a tailor. The farmer attempts to make neither the one nor the other, but employs those different artificers."

This idea was expanded by Smith, David Ricardo, and others to show how each nation should exploit the "comparative advantage" provided by its climate, natural resources, human skills, and other national assets. The comparative advantage argument for free trade is endorsed by virtually all economists, agreeing that a nation should concentrate on making those products for which it has a comparative advantage (not even necessarily an absolute advantage) and importing the others. Impressive proofs have been offered that the nation will benefit by not imposing tariffs and trade barriers regardless of what others do. Some economists, however, have come to believe it necessary to place restrictions and conditions on completely free trade when other nations behave badly.

History of tariff policy

Since nations are run by politicians rather than economists, national policies have often been based on protectionism rather than free trade, imposing tariffs and other restrictions against imports. In the U.S. the battle over tariffs has continued throughout most of the nation's history. Curiously, the Republican and Democratic parties have changed places in this debate.

In 1931, during the Hoover administration, the Republican Congress enacted very high tariffs in the Smoot-Hawley Tariff Act that is widely believed to have worsened the Great Depression of the 1930s. After that great failure, American policy was to work with other countries for the reduction of trade barriers. In 1934, during Franklin D. Roosevelt's first term, the Democratic Congress passed the Reciprocal Trade Agreements Act that led to negotiations and tariff reductions.

By 1993 the parties' positions had reversed. Republicans were pressing to enact a North American Free Trade Agreement (NAFTA) with Mexico and Canada, while opposition in Congress came mainly from Democrats. NAFTA had been proposed partly in response to the success of the European Common Market, which opened up trade among its members while maintaining barriers against outsiders.

President Clinton supported NAFTA and got it approved with the votes of most Republicans and some Democrats. Independent presidential candidate Ross Perot had campaigned against NAFTA across the country in 1992, predicting a "great sucking sound" as American jobs would be drawn to Mexico. Most labor unions also opposed it.

Why did the parties switch?

At the risk of over-simplification, one could say that for most of their histories the Republican party reflected the interests of the industrial North while Democrats were the party of the agricultural South. Although farmers, from time to time, have felt a desire for tariff and/or quota protection against foreign agricultural products, they built up a fierce resentment against high prices of manufactured goods they needed due to tariffs on those products. Northern industrialists, of course, favored tariffs that handicapped foreign competition against their products, often joined by their employees who feared for their jobs if imports captured the market.

Several things changed. The South, which had been solidly Democratic for generations, began switching to the Republicans when white Southerners were cultivated as a Nixon political strategy. Farm support for free trade weakened as factory farming displaced large numbers of farmers. Corporations, which generally had lobbied for high tariffs on consumer goods competing with their products and low tariffs on the raw materials they imported, found all tariffs a burden as they combined into multinational empires. The corporate trend toward global markets caused business elements in the Republican party to lobby against trade barriers.

Business interests also influenced the Democrats, but opposition to NAFTA came mainly from Democrats with labor union backing and from Perot's independent Reform Party. Historically, labor unions have been spotty in their attitude toward trade barriers. Philosophically, they often have favored free trade to bring down consumer prices, but when they perceived a barrier as necessary to protect jobs in a particular industry they sided with owners to demand protection.

Controlling the balance of trade

When governments seek to control trade, one method is by means of tariffs, quotas, or other trade barriers. Typically other nations retaliate and everyone is worse off. Another method is to monkey with foreign exchange rates (which could also have many other consequences). That is, if a government devalued its currency to make foreign goods cost more, imports would be discouraged. At the same time, its exports would cost less in foreign currencies and therefore be cheaper and more attractive in other countries. This would, at least in theory, tend to improve its balance of payments, unless, of course, other countries retaliated by devaluing their currencies.

History has shown that free trade and freely floating exchange rates, in the absence of government and central bank interference, find their own equilibrium. No country can run an unfavorable balance of payments indefinitely—the foreign currency borrowed to cover the difference must be redeemed sometime, which tends to drive up its cost in terms of the local currency until an equilibrium is reached.

Thurow wrote in 1996: "Since trade deficits can only continue as long as someone is willing to lend the deficit country the money necessary to pay for its trade deficits, the current pattern will essentially continue as long as Japan is willing to lend to the U.S. the money that the U.S. needs to pay for its entire trade deficit—a sum about twice that of the bilateral deficit between Japan and the U.S., since the rest of the world pays for its Japanese deficits with its American surpluses...."[41]

Are foreigners getting our national assets?

Concentration on the trade deficit may be distracting us from more important questions. As recently as 1980, according to Greider, the U.S. had a net surplus in "factor incomes" every year of $35 billion or so, equal then to 1.5% of the national income. That refers to all of the profits, dividends, and interest payments that American firms and investors collected from their investments abroad less the outflow of financial returns paid to foreign investors on the assets they held in America. In the fourth quarter of 1993, for the first time in nearly a century, the outgo of factor incomes exceeded the inflow.

Meanwhile, government and private borrowing abroad had turned the U.S. from a creditor to a debtor nation. In the second quarter of 1989 foreigners earned $31.9 billion on their investments in the U.S., surpassing the $26.9 billion Americans earned on their investments abroad.[42] For the first time in history, one economist declared, "an advanced industrialized nation had gone back to debtor status in peacetime."[43] Slavin noted in 1991 that foreigners owned about 10% or 12% of real assets in this country, and "at the rate they're going, within another 20 years they'll own more than half." He wrote that they owned half of the cement industry, one third of the chemical industry, and such American institutions as *TV Guide,* Burger King, Bloomingdale's, A&P, *Woman's Day*, Twentieth Century Fox, Smith and Wesson, and Tiffany's.

"The Japanese own L.A.'s Arco Plaza, New York's Exxon Building, Washington DC's *U.S. News & World Report* Building, Atlanta's IBM Tower, Las Vegas's Dunes Hotel, and most of the major hotels on Waikiki Beach," he added. "The British have $1 billion invested in Washington, DC real estate....In fact, foreign interests hold close to half the office space in downtown Los Angeles, about 40% in Houston, one third in Minneapolis, and a good 20% in New York.

"Foreign banks hold about 20% of all the banking assets in the US and provide perhaps 30% of all business loans....Some investment banking firms are owned in part by foreigners, while Aubrey G. Lanston was purchased outright by the Industrial Bank

of Japan....The British...now own three of the top five [advertising] agencies."[44]

After the strong dollar due to high interest rates at the start of the 1980s had stimulated imports and increased the debt owed to foreigners, the dollar began to slide in March 1985, making that debt represent greater value in U.S. assets. Reich said in 1988: "With the dollar priced so low, and American companies so uncompetitive, it's as if America announced a fire sale, with everything marked off the regular price." By then foreigners owned 12% of America's manufacturing base, setting a 20th century record. In 1980 it had been only 3%.[45]

Eisner, in 1994, was unworried by increasing foreign ownership of assets in the United States. He remarked that many American investments overseas had been made years earlier and increased in value, even if only by inflation, so that official statistics on a cost basis undervalued their current worth. "The bottom line," he wrote, "is whether we are paying foreigners more than they are paying us, and until at least the last year we have not been." He referred to 1992, when net investment income was positive at $6 billion, "and turned only trivially negative in 1993."[46] By 1996, it was positive but less than $3 billion.[47]

As Daimler-Benz announced an agreement to buy Chrysler Corp. in May 1998, the Associated Press reported that direct investment by German companies in the U.S. had grown to $7 billion in 1997, eight times what it was five years earlier.[48] The $40.5 billion purchase of Chrysler was surpassed in August 1998 as the biggest foreign takeover of a U.S. company when British Petroleum PLC agreed to pay $48 billion for Amoco Corp., strengthening BP's ranking in third place behind Royal Dutch-Shell and Exxon among the world's oil companies. It was estimated that 6,000 jobs would be cut, in what the Associated Press called "the biggest industrial merger ever."[49]

Global corporations and foreign governments

From the point of view of the multinational corporations, whether headquartered in the U.S. or elsewhere, America's trade deficits don't matter. A sale counts whether from a domestic or foreign factory, whether an export or an import. In fact, such

companies assemble products from so many low-wage sources that it is difficult to identify a "country of origin," and for tax reasons they manipulate prices between their subsidiaries so that official export and import figures become distorted.

Greider commented that when President Clinton promoted Boeing's aircraft sales abroad, "he was also championing Mitsubishi, Kawasaki, and Fuji, the Japanese heavies that manufactured a substantial portion of Boeing's planes. Boeing was offloading jobs from Seattle and Wichita to China as part of the deal...."

In addition to global corporations, other nations attempt to influence U.S. trade policies and rewrite U.S. laws in favor of foreign corporations. In the late 1980s, 92 Washington law, public relations, and lobbying firms were employed on behalf of the Japanese government and corporations, compared to 55 for Canada, 42 for Britain, and 7 for the Netherlands. Japanese corporations were spending an estimated $100 million a year on political lobbying in the U.S. and another $300 million to influence public opinion in the U.S. Later the Mexican government spent upwards of $25 million on its campaign for NAFTA.[50]

The extensive investigation by Congress in 1997 of alleged Chinese contributions to President Clinton's 1996 election campaign recalled the original "China Lobby" of Cold War days. Communism being the exclusive criterion for judging nations in the Cold War, our government blacklisted mainland China and subsidized Chiang Kai-shek's government-in-exile on Taiwan, which maintained the biggest lobby in Washington, generously rewarding its many supporters in Congress.

The new China lobby, this time supporting mainland China, consists of a one-trillion-dollar bloc of 55 major U.S. companies including General Motors, Mobil, Exxon, Caterpillar, United Technologies, Boeing, Cargill, Philip Morris, Procter and Gamble, TRW, Westinghouse, IBM and others. U.S. industrialists claim that freer trade with China means more jobs for Americans, but the truth is that China annually exports $51 billion or more to the U.S. while importing only $12 billion from the U.S.[51] Meanwhile, China demands that U.S. companies relocating there

hand over access to high-technology trade secrets and know-how.[52]

In 1995 by playing off General Motors and Mercedes-Benz over rights to manufacture and sell in China for fixed periods of time China ended up gaining sophisticated technology from both to design and build new models. By contrast, when China insisted on technology transfer in automobile manufacturing, Japan had said "no thank you" and opted out of the race.[53]

32. A NEW KIND OF TRADE WAR

Trade warfare, which has worried many policy makers and economists, is no longer a simple matter of raising tariff barriers against imports. U.S. tariffs were reduced from an average of 53% in 1930-33 to less than 15% by 1951. This occurred under the 1934 Trade Agreements Act, which allowed reciprocal reductions without Congressional ratification, as well as several international conferences following establishment of the General Agreement on Tariffs and Trade (GATT) in 1947. Because of reciprocity, tariffs of other countries were also reduced.

Tariffs, however, are not the only method by which nations discourage imports. Quotas are sometimes used, and even more often there are structural obstacles, such as official rules and local industry practices that tend to keep outsiders from entering the home market. Such barriers have been cited by the American automotive industry, for example, as preventing sales in Japan.

Trade warfare has also included forcing companies to reveal technology, often developed with the help of government subsidies, as the price of low-cost overseas production and/or access to home markets. Such methods were used by Japan to destroy most of the American electronics industry. According to Richard Florida and Martin Kenney's *The Breakthrough Illusion* (1990), the greed of U.S. companies for short term profit often caused them to sell their innovations to foreign companies instead of perfecting them in mass production at home.[54]

By the 1990s a change in the nature of capitalism had altered the terms of the battle over trade restrictions. No longer were the main protagonists nationalistic companies each seeking to invade foreign markets while protecting their home market. Instead, multinational corporations of dubious national identity sought access to global markets and fought against any restriction by governments, whether of working conditions, labor practices, consumer protection, product safety, or environmental responsibility.

Ironically, U.S. official policies had helped to create global corporations without loyalty to the U.S. even if headquartered here. Government subsidies helped U.S.-based corporations establish factories abroad, and the tax laws allowed advantages to such companies. As Greider wrote in the *American Prospect* (Jan.-Feb. 1997):

"It makes no sense for American taxpayers to subsidize the dismantling of their own industrial base or to provide various tax breaks to support the balance sheets of companies determined to globalize their employment base....If American companies are willing to operate factories where their workers are policed by communist cadres, if they accede to foreign demands for certain levels of investment, employment, and output, then they can surely learn to deal fairly with their own native land...."[55]

The business elite, converted from isolationism and protectionism to global market capitalism, now looks to international bodies for help in achieving its objectives. The World Bank and the IMF pressure borrowing countries to ease the way for global corporations to displace local agricultural and manufacturing industries, making local populations dependent on foreign sources for jobs and food. The North American Free Trade Agreement (NAFTA) and global trade agencies also aid corporations to prevail against national legislation.

North American Free Trade Agreement

Until the 1993 debate between Ross Perot and vice-presidential candidate Al Gore on the Larry King show, I was undecided about NAFTA. It would appear to be a good thing for the U.S., as well as for Canada and Mexico, so long as it didn't contain pitfalls. The treaty, as negotiated by the Bush administration, was considered by Clinton and Gore to lack safeguards against pollution and labor exploitation, so side agreements on these points were added.

Because Perot never explained his opposition by pointing out serious shortcomings in these agreements—preferring to dwell on problems that occurred before the Clinton administration took office, and losses of American jobs that occurred without NAFTA –I was inclined to accept Vice President Gore's assurances about

the side agreements. Subsequent events showed the agreements to be toothless, and certainly Congress did nothing to remove the tax and subsidy incentives from corporations moving their operations abroad.

The greatest harm was in the failure of protections against pollution and labor exploitation. As reported in a 1996 article in *Dollars and Sense*, “Corporations and their government allies in all three NAFTA countries vehemently opposed setting up institutions with strong monitoring and enforcement powers.” They had their way, as no budget was provided for enforcement.

NAFTA did not begin, merely accelerated, business moves for tax breaks, lax environmental regulations, and compliant labor. Proctor Silex, for example, had moved for these reasons from the northeastern U.S. to Moore County, South Carolina, and got the county to float $5.5 million of municipal bonds to finance sewer and water hookups for its expansion. Then it decided in 1990 to move again to Mexico, leaving the county 800 unemployed workers, many drums of buried toxic waste, and the sewer and water debt.[56]

The south side of the border, even before NAFTA, had attracted General Electric, Ford, General Motors, GTE Sylvania, RCA, Westinghouse, Honeywell and many other companies. The 620 *maquiladora* (assembly) plants employing 119,550 workers in 1980 had grown to 2,200 factories employing more than 500,000 Mexican workers in 1992.[57]

While the environmentally destructive operations of factories in Mexico seem to have been invulnerable to the protections NAFTA was supposed to bring, Ethyl Corporation may have found a way to use NAFTA to defeat pollution control in Canada. In September 1996 the company began steps to prevent the Canadian government from outlawing its exclusive product, MMT (methylcyclopentadienyl manganese tricarbonyl), designed to boost octane in gasoline. The Canadian government’s objection to MMT is the fear that manganese may be neurotoxic and also interfere with computerized pollution diagnostic systems.[58]

This is an example of how provisions of trade agreements designed to prevent national regulations from being used as trade

barriers have had the detrimental effect of undermining national and local health, safety, and environmental standards. Similarly, trucks crossing the border from Mexico have been made immune to California vehicle safety rules.

GATT and WTO

The success of FDR's reciprocal trade agreements, GATT, and several later international conferences at which GATT was extended, led to the creation in 1994 of the World Trade Organization (WTO). Based in Geneva, it enforces rules for world trade among developed nations. As members, countries forfeit some of their sovereignty and agree to abide by WTO rulings affecting their trade policies.[59]

As in the case of NAFTA, multinational corporations attempt to use WTO not only to break down trade barriers but also to undermine national and local rules on health, safety, workers' rights, and the environment. They can accomplish this by persuading any member government to bring a challenge under the following provision that lurks among some 2,000 pages of the GATT agreement creating the WTO: "Each member shall ensure the conformity of its laws, regulations and administrative procedures with its obligations as provided in the annexed Agreements."

WTO will not accept as valid the desire of a nation to reduce risks by enforcing stricter standards than those of WTO. Unfavorable WTO decisions cannot be appealed in federal or state courts. Challenges are heard in secret before a panel of three members who are usually lawyers experienced in representing corporate clients on trade matters. Their individual positions must not be revealed even after a decision is reached, even the documents presented in a case remain secret unless a government releases its own documents, and the defendant bears the burden of proof. All of this is undemocratic but highly favorable to corporations that want to ride roughshod over health, safety, human rights, and environmental protections.

David Korten (1995) declared: "Control of economic rules is one of the most important powers in the world today. Under the WTO, a group of unelected trade representatives will

become the world's highest court and most powerful legislative body." He also pointed out that, because GATT allows the WTO to change certain trade rules by a two-thirds vote of member representatives, its unelected bureaucrats have the power to amend the WTO charter without referral to national legislative bodies.

Detrimental actions of the WTO bureaucracy

Tobacco provides an example of the harm this mechanism can do. As tobacco has increasingly been under attack in the U.S. for its health hazards, tobacco manufacturers have sought new foreign markets and used political pressure to fight restrictions by foreign governments. When Taiwan proposed to ban tobacco advertising and cigarette vending machines and to fund a public education campaign against smoking, tobacco companies got the U.S. trade representative to threaten trade sanctions against Taiwan.[60] Similar pressure caused Korea to repeal bans on foreign tobacco companies, and male teenage smokers increased from 1.6% to 8.7% of the male teen population.

Another example involves a regulation under the U.S. Clean Air Act that was held in violation of global trade rules by a WTO panel in January 1996, responding to a challenge filed by Venezuela and Brazil. The panel refused to apply a GATT exception for valid goals, such as environmental protection. Unless the ruling were overturned on appeal, the U.S. would have to allow importation of dirtier gasoline that causes smog and air pollution, or else give up "equivalent" trade benefits or sanctions for the plaintiff countries.

Another anti-environmental ruling was issued by GATT in 1991 declaring the U.S. laws banning sale of tuna fish caught by methods that kill large numbers of dolphin to be an illegal trade barrier.[61] A similar issue was due to come before a WTO resolution panel in February 1998. India, Malaysia, Pakistan, and Thailand challenged the Endangered Species Act, under which shrimp sold in the U.S. must be caught using inexpensive "turtle excluder devices" that can reduce sea turtle mortality from shrimp trawling as much as 97%. On the panel of trade experts (with no particular scientific background) is one from Brazil, a country previously embargoed for failing to protect sea turtles from shrimp

trawlers. The dispute process is secret, not subject to outside appeal, and citizen groups are excluded.

A WTO challenge can even be used against state-supported non-violent human rights efforts. In late 1996 Thailand and Japan, joined by the European Union, complained that a Massachusetts law forbidding state agencies to contract with or invest in corporations with holdings in Myanmar (formerly Burma), a repressive military dictatorship, was against WTO rules. The Massachusetts law is part of an international human rights campaign. A successful challenge would force the U.S. to pay sanctions in order to maintain the state law.

In WTO cases, according to *Multinational Monitor*, the U.S. normally prevails as a plaintiff but loses as a defendant. In other words, countries tend to succeed when they challenge other nations' regulations (to protect health, safety, the environment or other interests).[62] The U.S. government, as challenger, has supported commercial attacks against environmental and consumer interests. Two important examples involve U.S. actions favoring agribusiness versus governments of other nations.

(1) Since 1996 the European Union has banned the use of artificial growth hormones on cattle. Acting at the request of the U.S. National Cattleman's Association, the United States Trade Representative challenged the ban, and the WTO panel, in June 1997, ruled it an illegal restriction of free trade, subjecting the UE to possible economic sanctions by the United States.

(2) The U.S., which does not export bananas, even challenged the EU over its policies giving preference to bananas produced on family farms and by unionized workers in Europe's former colonies in the Caribbean. The WTO ordered the EU to drop those preferences or face U.S. trade sanctions, thus benefiting Chiquita Banana's investments in huge Latin American nonunion banana plantations.[63]

The U.S. Trade Representative's Office came close in 1996 to supporting an industry front trying to get WTO in 1996 to ban consumer labels that provide information about environmental impact of products. It backed off when other federal departments joined the Sierra Club and Green Seal in objecting.[64]

How corporations influence American and WTO policy

The U.S. is not the only WTO member that is heavily influenced by powerful corporations, but it is worthwhile to see how American interests are represented in the WTO. Although the Federal Advisory Committee Act of 1972 requires a "fair balance," that has been taken to mean only that advisory committee membership must be representative of the business community. The public is never allowed to attend their meetings, and in December 1991 Public Citizen's *Congress Watch* reported that the members of the three main trade advisory committees included only two from labor unions and no consumer representatives. The other members were 92 from individual companies and 16 from industry associations.[65]

Major polluters were strongly represented on these advisory committees, whose members have access to a library of classified information and special communications links to the government negotiators. DuPont, Monsanto, 3M, General Motors, and Eastman Kodak, who made up half of the EPA's list of the top ten hazardous waste dischargers, were included, as were 27 companies who had fines assessed against them or their affiliates for failure to comply with environmental standards. Twenty-nine had contributed to an unsuccessful campaign against California's Safe Drinking Water and Toxics Enforcement Act, and 29 had put up over $2.1 million that defeated another California initiative called Big Green which would have tightened standards for the discharge of toxic chemicals.[66]

At meetings held between 1989 and 1991 of the Codex Alimentarius Commission, or Codex, that sets WTO's global food standards, only 26 of 2,587 individual participants came from public-interest groups. Nestle, the world's largest food company, with 38 representatives, was among 140 of the world's largest multinational food and agrochemical companies that participated in Codex. A Greenpeace USA study found that Codex safety levels for at least 8 widely used pesticides were lower than current US standards by as much as a factor of 25. The Codex standards allow DDT residues up to 50 times those permitted under US law.

Does free trade cost American jobs?

Despite the loss in the 1980s of so many well-paid blue-collar jobs in the United States as corporations moved their operations to lower-wage countries in the global economy, most experts have held that the solution is for Americans to hone their skills for high-tech jobs and let the less skilled work go to less developed countries. The double advantage would be to get the high pay and be able to buy cheap foreign-made products. This idea fits neatly with the concept of comparative advantage in classical economics.

Unfortunately for the United States and other developed countries, they no longer have a virtual monopoly on advanced technology. Some examples of what has already happened and is accelerating are given in a 1997 book by *Business Week*'s chief economist, William Wolman, and Anne Colamosca:

"Anywhere you go in Asia nowadays—China, India, Taiwan, or Singapore—you can find highly skilled workers designing interactive CD-ROM programs, producing programs that map three-dimensional images to diagnose brain disorders, designing digital answering machines or interactive computers for children....Citibank taps local skills in India, Hong Kong, Australia and Singapore to manage data and develop products for its global financial services....

"Penang, Malaysia, has become a global center for many components used in [Hewlett-Packard's] microwave products and has taken over responsibility for computer hard-disk drives from Palo Alto. More and more, specially trained Filipino accountants do much of the grunt work in preparing tax returns for multinational firms. All this overseas work is easily transferred via satellite links, computers, and e-mail....

"In Bangalore, trained medical transcriptionists with university degrees decipher American medical jargon and transmit transcripts overnight to Virginia hospitals, which need the work to be highly accurate and done quickly in order to discharge patients. The Bangaloreans get paid roughly one-tenth the $25,000 average salary of full-time medical transcriptionists in the United States.... India's software industry, which barely existed 10 years ago,

notched up sales of more than $1.2 billion in 1995 and has been growing at over 40% a year."

The basis for this success story, according to the authors, was laid in decades of free university education that was available to all classes. Although many poor families didn't take advantage of it, a middle class of about 120 million people was produced, "by far the largest educated class of Indians the country had ever known."[67]

Some economists have pointed to Americans who lost their corporate jobs but started their own businesses. This is part of a trend heralded by Alvin and Heidi Toffler in *The Third Wave* where mass production and mass consumption are seen being replaced by "customized production, micro markets, infinite channels of communication."

The supposed growth in small firms, however, does not seem to be supported by the figures. Wolman and Colamosca quote data from a 1990 Harvard University Press book by Brown, Hamilton, and Medoff that shows small firms became a slightly smaller proportion over a ten year period. Those with fewer than 100 employees dropped from 36.3% of all firms in 1976 to 35.0% in 1986. Firms with fewer than 500 employees dropped from 50.4% to 49.7% of all firms in the same decade.[68]

33. THE ARCANE WORLD OF FOREIGN EXCHANGE

Just as the financial news erupts from time to time with warnings from the "experts" that there is a crisis in the balance of trade and/or the balance of payments, also there are periodic panics over the value of the dollar in foreign exchange. Humans have millennia of experience with various units of exchange—that is, money. They have ranged from items of practical use, such as livestock, to symbolic and ornamental ones, such as wampum, silver, and gold. Today it is mostly in the purely symbolic form of paper (or electronic credits), although nominal amounts of precious metals are kept in national treasuries.

Governments have experimented with schemes to control the purchasing power of that symbolic paper currency. The United States went off the gold standard in 1934, but attempted to stabilize the dollar. For many years it maintained a huge hoard of gold at Fort Knox, Kentucky, and until 1971 stood ready to buy gold from other nations or sell it to them for $35 per ounce. This is one of the reasons the U.S. dollar became the *de facto* standard for international reserves and transactions.

Pegging international exchange rates

The International Monetary Fund (IMF) was set up in 1944 in an effort to control fluctuations in exchange rates and to end the cycles of devaluation and retaliation for export stimulus purposes. In theory, exchange rates could be adjusted to cope with long-run shifts in the strength of national currencies, but short-run fluctuations due to speculation would be stabilized with short-term loans from the IMF.

In practice the "adjustable-peg system" of IMF only rarely made the adjustments necessary to correct long-term disequilibria, so it became, in effect, a rigid exchange rate system. It collapsed in 1971, as the dollar became substantially overvalued and President Nixon ended the free inter-governmental conversion of the dollar to gold at $35 per ounce.

Since then, in an environment where exchange rates were allowed to "float" for the most part, national governments or their central banks have continued to combat short-term fluctuation by buying and selling their own currencies. There also have been some special arrangements, including the European Monetary System or Exchange Rate Mechanism (ERM) to peg currencies to each other in the European Common Market.

If there is a fundamental weakness in a currency, official manipulation will not save it, as has been demonstrated by many unsuccessful attempts. One outstanding example was the official rate for rubles in the Soviet Union. Nobody would trade at the official rate, so government was reduced to using barter for international trade. In the end stores were opened in Moscow where rubles were unacceptable and all purchases had to be made in U.S. dollars. That example was later followed in Cuba.

There has been much talk in countries whose money was losing value of the "gnomes of Zurich." Actually, trading in currencies by the Swiss banks is almost entirely for the account and under the orders of their customers, many of whom may be corporations and individuals in the home country of the currency. The effect of their trades can only be transitory.

I happened to be visiting in England in 1992 when the British pound, seriously overvalued against the German mark, was under attack by speculators. Both the Bank of England and the German central bank bought pounds and sold marks in a vain effort to bolster the pound. The British Chancellor of the Exchequer boldly declared that there would be no devaluation of the pound. Nobody believed him.

The rescue effort of the central banks was very costly to them, but large profits were made by speculators. I later learned that George Soros' hedge fund sold $10 billion of British pounds in a bet against the effort to prop up the pound and won an estimated $1 billion profit. Soros is a villain to some for his role in this crisis, but a hero to others for his charitable work.

The pound was devalued, of course, Britain withdrew from the ERM, and the actual weakness of the pound was demonstrated by its fall, measured against the Japanese yen, of

41% in eleven months. The central banks, like the currency speculators, could only produce short-term effects at most.[69]

The role of the financial community

The pressure for governments to support currencies often comes from banks. When the Asian financial markets took a precipitous drop in December 1997 and Asian currencies lost much of their value in foreign exchange, it was worry about banks having to write off risky loans to Asian countries, such as Indonesia, South Korea, etc., and to businesses run by family and friends of their rulers that was a major impetus to the international rescue effort. The IMF, the World Bank, the Asian Development Bank and the G-7 countries, including the U.S., rushed to pour in billions of dollars for the bailout.

A similar crisis had occurred in Mexico less than a year after the NAFTA agreement was ratified, as the Mexican stock market, in December 1994, lost more than 30% of its value in pesos. It was said to be due to political corruption that had been kept under wraps while support was organized for NAFTA. President Clinton provided more than $50 billion in U.S. taxpayer money from a fund set up to stabilize the dollar. As reported by Korten, this was "to ensure that Wall Street banks and investment houses would recover their money....When the US bailout linked the dollar to the falling peso, wary currency speculators sold dollars to buy German marks and Japanese yen—further weakening the dollar...."[70] Austerity measures imposed on Mexico caused further impoverishment and repressive government campaigns against the indigenous tribes rebelling in desperation.

Money supply and currency value

There is a close connection between exchange rates and monetary policy, because higher interest rates (that accompany a tight-money policy) attract foreign investment. The investors, seeking to convert foreign currency, drive up the price of the home currency. In May 1994 the Federal Reserve had made three interest rate increases of one-quarter percent each time in rapid succession, and home mortgage rates were 2% higher than the previous October, despite a 12-month decline in wholesale prices and a rise in new unemployment claims. It was suspected that the real reason was to prop up the dollar exchange rate.

An earlier example of this effect was in 1981 and 1982 when the Federal Reserve implemented a tight-money policy. Capital rushed into the U.S., where bonds were paying 15% while equivalent instruments in Germany and Japan returned only 5% or 6%, and the dollar rose sharply against other currencies. This had an effect on international trade. The expensive dollar was curtailing overseas sales, while the relatively lower value of foreign currency helped artificially cheap imports capture domestic markets, and heads of U.S. corporations visited the White House to plead for relief.[71]

From June 1980 to February 1985 the British pound dropped from $2.34 to $1.10 and the German mark from 57 cents to 30 cents, raising the dollar to dizzying heights. By March 1995 the dollar was being allowed to slide, but already, according to Phillips, "Third World nations like India, China and Brazil were no longer U.S. agricultural export markets; buoyed by high U.S. prices, they had become competitors."

34. THE CHALLENGE OF STRAIGHT THINKING

With so many misconceptions permeating economic assumptions and policies, is it possible to bring national decision-making back to reality? Given the enormous influence of the world banking structure and global corporations on the political structure, the media, and the economics profession, the task is formidable.

In the field of economics, there are unfettered minds that manage to form independent judgments and get published. The proof is in various sources I have quoted in this book. Although orthodox economics clings to pre-Keynesian classical dogma, just as scholars of the Middle Ages insisted on geocentric flat-earth doctrine, changes do occur in academic disciplines. One may hope that future events will result in more scope for economists who recognize that Keynes was right about the errors of classical economic theory.

Meanwhile, my advice to the individual reader is the same as I have often given to university students in economics and financial management courses: don't blindly accept any statement, not even mine nor the ones in the textbook (good textbooks report different sides of controversial matters). Look for at least two conflicting views on every issue and use your head to decide what you believe is true. Then, keep an open mind to be proven wrong by new information.

The more that people challenge the fallacies encountered everywhere, the better chance there is that public spokesmen will feel pressure to present facts rationally and the media to offer something better than sound bites sandwiched between commercials.

Policy consequences of misinformation

Not only are economic misconceptions harmful in the intangible realm of knowledge and understanding, but they also have catastrophic consequences for public policy. People are misled by measures of production that mask the costs of human

and environmental damage, by distorted government accounting, by specious arguments against progressive taxation, by inflation phobia that causes wasteful unemployment, by confusing democracy with materialism, by the idea that bigger is always better, and by unquestioning faith in financial markets and corporations. Because of this, the United States and the world face much more serious problems than those that hold the attention of the mass media.

Several authors have made a convincing case that we are now experiencing an important turning point in history. The Tofflers' *The Third Wave* (1980) rated the current era of rapid change as important as the Agricultural Revolution (when nomadic herdsmen settled on the land) and the Industrial Revolution. Their account of mass production and mass consumption being replaced by customized production, micro markets, and infinite channels of communication was criticized by Wolman and Colamosca for neglecting "to inform their public that this devolutionized system of production continues to be dominated by the great multinationals."[72]

Thurow, in his 1996 book, *The Future of Capitalism*, used the analogy of tectonic plates to describe the world's current upheaval, listing their economic counterparts as (1) the fall of Soviet Communism, (2) a shift toward mobile brainpower industries, (3) huge demographic changes, (4) replacement of national economies by a global economy, and (5) lack of an umpire to enforce rules of the economic game.[73]

In the midst of this ferment, aside from the lingering threats of nuclear war and terrorist attacks, the major challenge to democracy and human progress involves the domination by corporations of the institutions of self-government. Democracy has always had an uphill fight against various forms of tyranny. It has made much progress in the developed countries that have put behind them the absolute monarchies and the doctrine of the divine right of kings that prevailed until the 20th century. Today's major challenge is to overcome domination of government by corporations, and it is made more difficult when the corporations are actually bigger than the national governments.

In the United States the most blatant forms of bribery may be rare, but through concentrated corporate control of the information media, as well as corporate favors and campaign financing to politicians, the rulers of big corporations tend to get their way most of the time. On the world scene, global corporations (including global bankers and financial companies) dominate international agencies unrestrained by democratic safeguards.

Campaign finance reform

The key reform in U.S. politics, upon which almost all economic reforms depend, is campaign finance reform. Television has made campaigning so expensive that fund-raising is a perpetual burden to elected officials, and their contributors, who are mainly corporations and their controlling stockholders, expect gratitude. Although it is illegal for corporations to contribute to political campaigns, they seem to have done so by various loopholes and subterfuges.

The solution is conceptually simple but politically daunting. Government could restore the requirement that broadcasters serve the public interest and that they maintain fairness by providing equal time to opposing sides of controversial issues, including election campaigns, and there could be requirements for a reasonable amount of time for debates, instead of hit-and-run attack ads. At the same time, limits could be placed on campaign contributions in some of the ways that have already been incorporated in proposed legislation.

Most politicians give lip service to campaign reform, but many content themselves with denouncing campaign financing of those in the opposite party and show little enthusiasm for limits that would affect themselves. Requiring broadcasters to provide free time on an equal basis to candidates in each election would reduce the dependence of politicians on campaign donations, but the demonstrated political power of the broadcast industry makes this seem most unlikely.

Outlawing paid political ads on TV would encounter the additional problem that the Supreme Court has interpreted the Constitution to give corporations the right, as free speech, to lobby

Congress, propagandize the public on political issues, and make undisclosed and tax-deductible donations to organizations that aid the campaigns of favored politicians.

Attempting to reform campaign finance in ways that would not run afoul of Supreme Court rulings, the bi-partisan McCain-Feingold bill got a bare majority in test votes in the Senate but was killed on February 26, 1998, when the majority leader removed the bill from the agenda after threats of a filibuster. It got another chance some months later when the House of Representatives passed the Shays-Meehan campaign finance reform bill (the House version of the McCain-Feingold Senate bill) but this also died in the Senate.[74]

Attempts at the state level to reform political campaigns in North Carolina were thwarted when a federal judge, Terrence Boyle, on April 29, 1998, declared state legislation unconstitutional which prohibited corporate political contributions, required groups seeking to influence any election to report their finances, and prevented lobbyists from making contributions to legislators while the state legislature is in session. His ruling is to be appealed by the State.

If there is no other way to overcome the favored status courts have given to corporations, it would have to be accomplished by constitutional amendment, making the limitations and responsibilities of corporations so clear the courts could not interpret them away. Constitutional amendment would also be necessary for at least some of the changes in the political system proposed by Phillips in his 1994 book, *Arrogant Capital*: (1) dispersing power away from Washington by letting Congress vote electronically from home districts and meet sometimes away from Washington, (2) emulating parliamentary systems where legislators can serve in the cabinet and new elections can be called when gridlock occurs, (3) using nationwide referendums and proportional representation to upset the two-party political monopoly, (4) reducing outgrown Congressional staffs that have become cozy with lobbying interests, and (5) adding national referendums as an alternative method of amending the Constitution.[75]

Amending the U.S. Constitution

The Founding Fathers provided two methods for amending the Constitution. They did not intend it to be easy, and it isn't, but it is not impossible. The piecemeal method in which Congressional proposals are submitted for ratification by the states has been used for all the amendments made so far. If it were not for Constitutional amendments, we would have no bill of rights, there would still be slavery, voters could not elect Senators, women and blacks would have no vote at all, taxes could not be based on income, and presidents would have unlimited terms.

It is unlikely that Congress and the states will make the necessary changes affecting corporations and campaign funding by piecemeal amendments. There are some hopeful signs of effective public resistance to corporate lobbying when issues become prominent enough. For example, despite the money showered on politicians by tobacco interests Congress balked at approving limitations on victim's lawsuits, President Clinton was denied "fast track" authority to prevent Congress from amending trade agreements, and public protest made the Department of Agriculture back off its proposed labelling of organic foods according to the permissive definition wanted by agribusiness.[76] Congress, however, seems unwilling to pass either a law or a Constitutional amendment to control improper influence.

The alternative would be to resort to the other procedure provided in Article Five of the Constitution, the convention method, which has never been used in over 200 years. It would be invoked by application of the legislatures of two-thirds of the states to Congress, which then must call a convention to propose amendments that will be subject to ratification in three-fourths of the states either by their legislatures or by state conventions.

Stuart Chase called vainly for a constitutional convention in 1934 to deal with public utility regulation by federal incorporation of all interstate business. He quoted David Lilienthal that "the utilities have regulated the regulators" and observed: "There is no rhyme nor reason in New Jersey's mothering a corporation with a head office in Pittsburgh, and branches in every state in the union....The calling of a Constitutional Convention...would open the way for

modernization and for more effective federal control...." It didn't happen then, but perhaps it's time to try again.[77]

A Constitutional Convention would not be limited to reforming campaign finance and defining the rights and responsibilities of corporations, but could take up other issues. Some people would call this opening a can of worms. Partisans of a particular cause might favor or oppose having the convention based on whether they thought their views would prevail. Assuming that the convention actually came into existence, it would be surrounded by public controversy over its work, and the issues getting the most attention in the media might not be the most important. There is no guarantee that the convention would reach agreement on constructive changes, nor that the states would ratify the work of the convention.

Whether it is possible to amend the Constitution by the complicated steps required for a convention remains to be seen. It is a bit strange that people who heartily approve the results of the original Constitutional Convention are afraid of having another one. Lawyers and judges may be the most formidable opponents, and lawyers tend to dominate the legislative bodies whose action is needed. Quirk and Bridwell's 1992 book, *Abandoned: The Betrayal of the American Middle Class Since World War II*, describes their opposition:

"...Law professors and judges, such as retired Supreme Court Justice William Brennan, tell us the Supreme Court is our 'continuing Constitutional Convention.' At the same time they tell us to be afraid of a real convention because it might 'run away.' Where would it run away to? Whatever the convention does has to be ratified by three-fourths of the states. What *are* they afraid of?...Pat Buchanan, in *Right from the Beginning*, calls for a second constitutional convention....The call for a convention, Buchanan writes, will 'reveal which of the two parties is a populist, and which elitist, which trusts and which fears the people.'"[78]

Given sufficient public concern, amendment by Constitutional convention may succeed and solve a host of problems. Even if the obstacles prove too strong, the very fact that an effort is being made could provide the impetus for

Congress to enact some of the reforms that are permitted by the Constitution but have been gridlocked in the system.

Other national actions

Constitutional amendment is an ambitious and usually lengthy process. Meanwhile, there have been some other proposals worth considering if they could be accomplished over the powerful opposition of the corporate rulers. Eisner proposed more relaxed monetary policies, allowing national debt to grow in proportion to GDP, a fair loophole-free tax system, and government policies to invest in education and infrastructure.[79] Phillips likewise suggested reform of central banks, as well as government policies favoring work and wages instead of global competitiveness, reining in the financial industry and the Federal Reserve Board, using tax provisions to discourage exporting of jobs, and countering the concentration of wealth by raising taxes on the "really rich—as opposed to the not-quite-rich."[80]

Similarly, Kuttner proposed returning to the objective of full employment instead of NAIRU, strengthening unions, providing universal health care, increasing education, promoting profit sharing, and perhaps rewarding socially responsible corporations with tax and other preferences.[81] Most such suggestions seem to have little chance, however, until something is done about campaign finance reform and corporate political influence. National action to combat the loss of jobs overseas has also been proposed and is highly controversial because of the powerful arguments in favor of free trade. Some economists (including Eisner and Krugman) do not consider import competition a major cause of American job problems.

Trade restrictions

One measure to reduce exporting of jobs does not involve any restrictions on trade, and that would be to remove the subsidies and tax advantages that encourage companies to move their plants overseas. Other proposals aim at fairness and equity rather than protectionism in the traditional sense. Kuttner, for example, suggested making free trade conditional on "a floor of common social standards and pay-for-productivity norms."[82]

Phillips wanted to compel exporting nations to do a fair share of importing and require trading nations to honor labor rights.[83]

Products could be excluded that are made by slave, prison, or child labor, as well as those produced under conditions that threaten human health or the environment. Such restrictions have been proposed and even (imperfectly) applied. Restrictions on products of gross environmental exploitation might put useful pressure on the companies involved. Any conditions or restrictions on trade, however, may conflict with WTO or NAFTA rules. The U.S. would have to utilize some of the escape hatches in GAAT that are employed by other nations, reform WTO to prevent exploiting and polluting industries from getting favorable rulings in secret tribunals, and/or risk fines for retaining the restrictions. Such fines, nevertheless, might be less costly in many cases than accepting or competing with substandard practices.

Meeting the challenge of globalism

Actions at the national level may be largely fruitless. All the powerful forces in society, especially public officeholders of both parties and most of the information media, insist that the global economy is inexorable. Reports of its harmful effects, as described throughout this book, usually appear in specialized publications, only occasionally surface in newspapers and magazines, and are rarely mentioned on television, which is where most Americans say they get their news.

The message is that globalism will have its way, individuals must adjust to the demands of unrestricted global markets, and all will be well if people just get the high-tech training needed to compete in the modern interconnected world. Since educational levels in the U.S. continue to rise, but median real family incomes have been stagnant since the mid-1970s, there is little evidence to suggest that the prescription will help most people.

If the United States and other nations can't resist the global corporations and bankers, doesn't it make sense to restrain them at the global level? Big business needs agencies its own size to enforce fair trade and protect the public—in other words, traffic control to keep the juggernauts from running over the pedestrians.

Some of the United Nations agencies ought to be filling at least part of this role.

The most modest method of controlling global excesses would be to reform those agencies, specifically the World Bank, IMF, and WTO. The walls of secrecy should be removed, independent outside experts should be used, and the policy-makers and advisory groups should include balanced representation of the interests involved, not dominated by the global corporations. The World Bank should include experts not beholden to the financial community; e.g., economists from labor organizations, consumer groups, and the academic world, as well as environmental organizations and experts from the countries involved in their development programs. The same should apply to the IMF, although it really is redundant since the collapse of the pegged currency system. The WTO should include balanced representation of consumers as well as producers, and judges on its tribunals should be independent scientific experts who can distinguish legitimate environmental concerns from mere pretexts, especially in the matter of food safety.

With these reforms, it could be hoped that the agencies would not impose their brand of economic systems on loan recipients, nor interfere with nations desiring a higher level of safety and environmental protection than world standards. Perhaps local industries and indigenous peoples would be given more respect, and UN agencies would stop underwriting projects where multinational companies work with corrupt local officials to use violence against the inhabitants. The agencies might also stop sending money to tyrants who stash it away in numbered accounts. Working for these reforms is worthwhile, but all changes must come through the UN member nations, which generally have shown no signs of limiting the growth and power of multinational corporations.

Is world government the answer?

The ideal solution may lie in some form of world government. Thurow recognizes that a global economy requires "an elected democratic world government" but believes it would be opposed by political forces on both the left and the right.[84]

Global government may seem out of step with modern trends, as viewed by many observers—differentiation, devolution, and small-scale operations in some cases having occurred as predicted in Tofflers' *The Third Wave*. Likewise, the formation of smaller political units through the breakup of the Soviet Union and Yugoslavia fits the Toffler concept. On the other hand, most worldwide economic activities seem to show a trend toward larger scope, such as the European Community, NAFTA, WTO, and expansion of NATO. Certainly corporations have been merging at a frantic rate and across national boundaries.

World government is indeed a utopian concept, but the world economy is largely being governed already by global corporations and global financial and trade organizations that are neither democratically controlled nor open to public view. There is little to choose between world tyranny of a political empire and world tyranny by an oligopoly of commercial cartels ruling in concert with local dictators.

If the UN is to become the umpire to enforce rules of the economic game, it will need considerable changes in its charter. Delegates to the General Assembly too often represent non-democratic regimes rather than the countries' populations. In fact, all posts in the UN are filled by governments, none by election (unlike the European Community, which chooses its parliament by election). The development of a democratic world government must necessarily be a slow process, to insure that elections of delegates are free, but a start must be made.

With all its faults, the UN has already been more effective in preventing wars than its weak predecessor, the League of Nations, and has saved many lives, especially through UNICEF and various peace-keeping missions. Lesser levels of government certainly are no match for the giant corporations that have no loyalty to any country and habitually buy control of politicians wherever they operate. The objective should be global democratic institutions strong enough to maintain a level playing field for business and finance, and answerable to the people of the world, not just to national governments. This goal will be difficult to achieve, but certainly a worthy challenge for all who seek the betterment of humankind.

A final thought

If the solutions I have suggested seem impossible to achieve at the both national and global levels, many reforms of the past have seemed impossible and took a long time to accomplish. Often it seems that things don't get fixed until they get really bad. The "economic royalists," as FDR called them, had created many problems that culminated in the 1929 stock market crash and the Great Depression. Only when it got that bad did the public ignore the editorial advice of the overwhelming majority of newspapers and elect a new President and Congress.

In President Franklin Roosevelt's first 100 days, a multitude of neglected problems were tackled to provide a "New Deal" for the "Common Man." FDR was credited with saving the nation from a radical revolution. Important among the reforms of the Roosevelt administration was the SEC, enforcing a greater degree of honesty among financiers and corporate management. While we would not welcome a national disaster like the crash and depression, the ordeals now being suffered might hasten a solution to some of today's problems.

NOTES

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PART FIVE: CORPORATIONS RULE THE WORLD

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