CONGRESSMAN'S REPORT
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# The Silent Revolution in Economics
## *III--A River Called Money*

In the first two reports of this series I have cited the statistics of our present, record-breaking economic advance and probed into those emotional concepts, debt and inflation. In the final report I want to explore with you the economic theory which lies behind this "silent revolution."

My late father, most businessmen I know, and most Members of Congress (including myself) would feel a lot more comfortable if our federal government could maintain a balanced budget <u>every year</u> while all of us continued to enjoy a steady increase in profits, income and standard of living. Unfortunately, say the economists -- and history seems to bear them out -- you can have one or the other of these things, but in times like the mid-1960s you can't have them both, any more than a farmer can have lush, healthy crops and also have the sun shine every day.

Oddly enough, the heart of this "new" economic theory, the explanation for our difficulties in combining economic growth with balanced budgets, sounds very much like the advice of a Wall Street banker or conservative Main Street businessman. It is simply this: <u>Demand must match supply if the nation is to prosper</u>.

Now what does that have to do with the federal budget? More than you might imagine. For the government not only takes taxes from us; it uses that money to buy buildings and highways and uniforms, and to pay mailmen and secretaries and soldiers. In other words, the federal government is a customer for America's goods and services--in fact, our biggest customer. And it is this customer role that lies at the heart of the "new economics" now guiding this nation's economy. It's part of what is known by economists as the "aggregate demand theory."

### WILL THE <u>REAL</u> BUDGET PLEASE STAND UP?

I'll return to that shortly, but first I want to look at still another hidden aspect of federal budgeting. The "federal budget" you read about in the newspapers is the so-called "administrative" budget. This year it calls for spending $99.7 billion and collecting $94.4 billion in taxes -- a deficit of $5.3 billion.

But the federal government will collect far more money than this, and it will spend more too. This is because certain collections and expenditures are considered separately; these are the huge trust funds -- Social Security and Highway heading the list.

Social Security contributions are collected from nearly every working American and nearly every employer. But they don't show up in the administrative budget. They are paid into a separate trust fund, and out of this fund are paid benefits to older citizens, widows and disabled workers. Similarly, taxes on gasoline, tread-rubber, trucks and buses are paid into a trust fund, from which we finance most of our federal and state highways. But these funds don't show up in the administrative budget either. When all of these separate trust funds are considered and purely paper transactions set aside, we get a quite different picture of our federal budget. Here are the actual figures for fiscal 1964:

| (In billions) | Administrative Budget | Trust Funds | Cash Budget |
| --- | --- | --- | --- |
| Money taken in | $89.5 | $26.0 | $115.5 |
| Money paid out | 97.7 | 22.6 | 120.3 |
| | -8.2 | +3.4 | -4.8 |

Thus, the overall impact of federal tax collections and spending in that year was not the deficit of $8.2 billion we read about, but a cash deficit of $4.8 billion. And in some years we will find that an administrative "deficit" actually conceals the fact that the government is taking in more than it is spending. When this occurs, we face yet another term I promised to discuss in this report -- the concept of "fiscal drag."

## DOING THE 'FISCAL DRAG'

The "fiscal drag" concept relates directly to the government's role as a customer for our country's goods and services. Simply stated, it refers to that situation in which the government saps more dollars from the economy than it puts back into it. Economists tell us this has a depressing effect on business, profits and jobs.

The federal government -- because it is our biggest customer -- can reduce the total demand for the products of our economy by spending less than it takes in. At certain times this would be desirable, the economists say; for example, when there is full employment and a shortage of goods to meet demand. But in normal times, or times of under-employment, such a deficiency in government spending can leave industry with unsold units, industrial plants without contracts, and workers without jobs.

All this the federal government can do, much of the time, through its own spending decisions. But not to be forgotten is the fact that the states, too, can contribute to this "fiscal drag." They, too, may take more out of the economy than they put back in through their spending programs. And on certain occasions it will happen that a deliberate federal deficit, intended to increase demand for goods and services, will be offset by state surpluses, causing an unintended and unplanned drag on the economy. (Incidentally, this is one reason, economists say, that the federal deficits of the 1930s didn't accomplish more.)

## THE RIVER OF AGGREGATE DEMAND

Now let's get back to that business of "aggregate demand." Briefly, this is a way of looking at a nation's economy from the standpoint of the total demand for the things it produces. As any businessman knows, a business will soon fail if it regularly produces more units than people buy. What the economists of the last 30 years have come to think about is the total demand for the goods and services of a nation. And no such appraisal can ignore the large part that government purchases play in this total demand.

But there is a perennial problem that arises in a free enterprise system such as ours. This is the fact that people and corporations and units of government save; that is, they hold back some the demand made possible by profits and wages and taxes. And the result is that, at times, there is insufficient demand to buy all our products and employ all our people. When this happens, as in a single business, trouble develops. We call that kind of trouble a "recession" or, if it's really serious, a "depression."

While any analogy poses problems, and this one is no exception, I want to try to put all of this in more understandable terms. Let me liken our national economy to a huge river valley and see how these concepts of the economists might be expressed more clearly. We'll call this huge stream the "River of Aggregate Demand."

## WATER EQUALS MONEY

Here we have a big, prosperous river valley -- virtually self-contained. Its life depends on the water (money) in the river. Its industries and farms all use water. Much of its food comes from the fish in the river. All of its people and all of its business activities take water from the river, and, after using it, put some or all of it back into the stream.

Water used in the uplands finds its way back into the stream and is reused over and over again before it reaches the sea. But in spite of this re-use and many efforts at economy we find that some people and some businesses are getting insufficient water. Some fields are standing idle because there isn't enough water to irrigate them. Some of the people are idle because there are no crops for them to pick or jobs for them to fill in partially idle factories.

At the same time the population of this great river valley is rising, and even more jobs will have to be found for these new people.

Now comes a hydrologist, who surveys the valley and its water needs. "Part of the trouble," he says, "is that too many people are storing water instead of returning it to the river. It isn't getting reused. If it continued downstream, many people could use the same water before it reached the ocean. But now it's just sitting there."

The hydrologist tells us the total flow of the river, counting all the re-uses, is 650 billion gallons a year, divided as follows:

| | Taken out | Returned |
|---|---|---|
| Private individuals and business | 460 | 450 |
| 50 big cooperatives with names like Arizona, Texas and Vermont | 70 | 70 |
| One valley-wide cooperative performing services for all -- called "Federal" | 120 | 114 |
| Totals | 650 | 634 |

Some might say that, despite its troubles, the valley is doing rather well. Its "Federal" water budget is not only balanced; it has a 6 billion gallon surplus. In fact, it could pay off part of its "national water debt" if it had one. But the hydrologist points instead to the river as a whole and notes the deficit of 16 billion gallons. He says, "There is the reason those farms are idle and workers unemployed."

What is to be done? At first the hydrologist implores the private individuals and businesses to release their stored water so it can be used and reused downstream, putting people to work in the factories and farms receiving its benefits. But these water-savers are reluctant to do this; they fear they will lose their savings and gain nothing in return.

Then the hydrologist asks the 50 big co-ops to see if they can't borrow some water, possibly from the private individuals and businesses, and put more flow into the stream. But the 50 co-ops have 50 different ideas about the problem, and anyway they don't see enough benefit to themselves to take such action.

Finally, the hydrologist goes to the super-big "Federal" co-op and suggests that it act on behalf of all the smaller co-ops and all the people of the valley. He says, "There isn't enough water flowing in the river to irrigate all the farms and operate all the factories. People are out of work because of this. Someone has to borrow some of this saved water and put it back in the river. No one else will do it; you will have to."

And so the Federal co-op goes to the private individuals and businesses that have been saving water, and it borrows 8 billion gallons, issuing "water bonds" which it will repay 10 years later with interest of 3%. This interest is obtained by taxing all of the people, including the people receiving the interest, a certain portion of their water. So many people and so many businesses buy these "water bonds", attracted by the prospect of getting more water in return, that when the Federal co-op starts paying this interest it has almost the same effect as putting it back into the river.

When the 8 billion gallons is poured into the river, we find that the Federal co-op no longer is taking more than it returns. Now it's returning 2 billion gallons more than it takes out.

What happens downstream? Well, that additional 8 billion gallons starts to turn over. This water is used and reused. And, instead of adding 8 billion gallons to the river supply, we find that <u>re-uses</u> add up to another 8 billion, making a total of 16 billion gallons of new water registering in users' water meters. Now idle farms go into production, partially-idle factories gear up and hire new workers. Unemployment declines sharply as people go back to work. And lo and behold, wonder of wonders, even the climate starts to change because of all that additional water on the fields. The rains increase and the flow of the river rises, making even more irrigation possible, enabling new factories to come into being, and creating more jobs, especially for all those new workers coming of age in this period of expanding population.

No longer is there a deficit in the river flow. The Federal co-op may show a deficit, but the <u>river</u> itself is "in balance." And now we find many businesses releasing additional amounts of stored water into the stream, increasing the volume of their own business activity in the process--and increasing Federal tax revenues too.

But, someone wants to know, how does the Federal co-op pay back the water it borrowed? The hydrologist explains: "By borrowing another 8 billion gallons." But how does it pay the interest? He replies: "By taxing all the people a small portion of their water -- about 1 1/2%." But how can the citizens afford to pay these water taxes? His answer: "Because they're now getting many times the amount in new water." But how long can this go on? He replies: "Just as long as the valley retains confidence in the Federal co-op and in its faithfulness in repaying each loan and meeting each interest payment when due." But isn't this unprecedented? "No," he replies, "AT&T has been doing the same things for years!"

## ENOUGH! BACK TO THE SIMPLE LIFE!

I can imagine some of my readers at this point waving their hands and shouting, "Stop! It's too complicated and it won't work. Let's go back to the way things were before!"

When before? In my first report I reviewed the dismal history of the last century during which the average period of business expansion has been just 25 months, in each case followed by a recession. Now, for the first time in our history, we have broken with that pattern. We are now in our 54th month of continuous economic growth which had doubled our production of many goods, greatly increased profits and pushed salaries and wages to an all-time high.

Going back to the "simple life", in hopes of achieving the psychological solace of a balanced federal budget, might require a very heavy price. The economists (the "hydrologists" in our little story) say it would mean heavy losses in our Gross National Product, tax collections and standard of living.

But, having told this little story and explained as well as I can the thinking behind our current national fiscal policies, I will frankly say that I, too, would prefer that we could return to simpler times. Just as the successful medical specialist dreams of the dedicated life of a country doctor, so I dream of the virtues of small-town America with its quiet and simple pleasures. But this is no longer a rural nation; most of our people today live in the city, depend on industry for jobs, and are caught up in a very complex economy. For the government to make its taxing and spending decisions based on an image of a simple, rural economy that no longer exists would be to invite disaster. At least, this is the case the economists make.

## BUT ISN'T THIS A 'PLANNED' ECONOMY?

Yes, but isn't this a "planned economy" in which, contrary to every American tradition, government tries to plan our lives? Isn't this socialism or maybe communism?

George Champion, the chairman of the board of the Chase Manhattan Bank, said as much recently. He wrote: "The case of the government that thinks it knows more than the marketplace about how to run the economy is nothing new in history. This was one of the root causes of the American Revolution." He says we are faced today with "centralized domination" that would "destroy the incentives that have made our country and our economy the envy and aspiration of the world."

I think Mr. Champion is wrong, and I find no justification to the charges that we either have or are likely to have a "planned economy," socialism or communism.

I am not saying these new economic policies are necessarily right, nor that we should not explore every alternative, but I think we ought to keep certain things in mind with regard to these charges of socialism and "economic planning" so freely applied to any innovation in fiscal policy.

Seeing the miseries of poor people living under kings and despots, Karl Marx envisioned a government run by the people (the proletariat) in which the people, through their own government, would own the farms, factories, railroads and all other means of production and distribution. Marx saw everyone benefitting and sharing in what he thought would be an abundance -- not on how hard he worked or what he contributed, but according to his needs. But Marx's theories have proved a miserable failure because they ignored basic human nature and the need for incentives, rewards and opportunities to advance.

It is a remarkable fact of recent months that the Soviet Union (which twisted Marx's dictatorship of the people into a brutal dictatorship of a few self-appointed leaders) has now come to recognize that there can be no efficient production or distribution of goods without incentives, competition and attention to consumer preferences. Pravda has reported significant changes in this direction.

On the other hand, our economic system has succeeded precisely because we have recognized the need for these elements. While our government does, indeed, interfere with the economy to prevent monopolies, impose minimum wages and check bank failures, it tells no one what career to pursue, how much he can produce, the profits he can make or the goals he can seek. In this broader sense we do have a free economy, and it is more free, I believe, than any other in the world.

Under our system there need be no class struggle, for the welfare of owners, investors, managers and employees is all bound up together in making the system more productive. This is a fact which enlightened businessmen and labor leaders both recognize. It was Samuel Gompers, founder of the American Federation of Labor, who said:

> "I want to tell you socialists that I have studied your philosophy--I have heard your orators--I have kept close watch upon your doctrines for 30 years and know how you think and what you propose. I know too what you have up your sleeve. Economically you are unsound; socially you are wrong; industrially you are an impossibility .... The worst crime against working people is a company that fails to make a profit."

America and its economy have gone through drastic and revolutionary changes in our 176 years. The auto has replaced the horse; in our industrial revolution the factory has largely replaced the farm worker; and the city has replaced the farm. I said in my first report that fundamental ideas rarely, but sometimes, change. And I have reported the important changes which are occurring in our nation's fiscal policies. But I think we owe our success, in large measure, to three basic features of our society which have never changed:

1) An economic system based on incentives and profits.
2) A great system of personal liberties under law.
3) A government which acts only by the consent of the governed.

My mail on these newsletters indicates that reasonable people can and do disagree on tax policies and economic policies and welfare policies -- yes, and on defense policies of this nation. Those that are wrong, those that fail to work can be changed. Those that work can be retained. But these three conditions, in my judgment, are the foundation on which this successful nation is built. May they never change.

We have a great and prosperous nation. But in nearly two centuries our greatness has been far more enduring than our prosperity. Through this "Silent Revolution in Economics" which I have been discussing in these reports perhaps -- just perhaps -- we will succeed in making this great nation of ours even greater.