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TSL the sommers letter
since 1980
continuing appraisal of the financial, industrial and policy outlook

November 19, 1991
91-30

Still More Weakness

- The fourth quarter of this year now looks still weaker, on the basis of figures for automobile sales, retail trade, labor market conditions, and inventory conditions.

- The labor market is tough, tough. The growth in employment has stopped, and weekly insured unemployment has risen rather steeply. Job advertising volume is near an all-time low. It's not surprising that surveys of consumer attitudes, by The Conference Board and by the University of Michigan, report another considerable decline. All of this casts a grim shadow over Christmas trade.

- Inventory conditions are now bewildering, and a further source of caution. Inventories rose sharply in September, at a time of stagnant output and trade, suggesting that a great deal of the rise was involuntary. The suggestion is that there will be no inventory thrust of any consequence to strengthen activity in the fourth quarter.

- In other markets closely associated with the business cycle, the weakness is too pronounced to suggest any cyclical strength at all. Auto sales are running below the third-quarter rate, precipitating further cutbacks in production schedules. Capital spending (for which there are no new statistics at this writing) is unlikely to go anywhere; anecdotal information on capital spending plans has been generally negative.

- The TSL model dated November 11, which marked the second considerable downward revision in both growth and inflation, is clearly not too low. It called for a 0.8 percent increase in output in the fourth quarter, near the bottom of the then consensus; the consensus is obviously moving down. For 1992, the model called for a 1.9 percent growth rate; the consensus has already moved from its 2.7 percent level of a month ago to 2.4 percent now.

- Careful and cautious planning is still obviously the way to go, at least until a combined response of monetary and fiscal policy begins to be clarified.

The Conference Board, 845 Third Avenue, New York, N.Y. 10022 (212) 759-0900

This **Sommers Letter** was intended to be on the supply of capital, raising and exploring the question of whether that supply is finite, as seems to be assumed in the journalistic reporting of saving flows, investment flows, and credit availability generally. The subject, an important issue in the prospects for interest rates, will be looked at in a later issue. Recent figures, in a host of important statistical series, have been weak enough to require prompt comment, particularly relating them to the **TSL** model dated November 11. The behavior of the equity market on November 15 may have reflected many individual conditions within the market, but its dimensions were certainly attributable to increasing doubts about the stability of business in general.

Since the November 11 model was printed, new figures have become available on the fourth-quarter trend of automobile sales and production, inventory conditions, retail trade, the industrial production index, the weekly change in insured unemployment, and prices at both the producer and consumer level. Some of these figures are basically September data, some of them are October data, and some are for late October and early November. Even the figures that are for September have a considerable bearing on what is likely to happen in the fourth quarter. <u>In general, they suggest a very weak fourth quarter, with the growth rate clearly below the level of the third quarter (which may be revised upward somewhat in late November) and perhaps no more than between zero and 1 percent</u>. (The **TSL** model called for a growth rate of 0.8 percent in the fourth quarter; it is distinctly in the low range of the consensus, but it does not now look at all too low.)

The automobile industry is plainly having a poor model introduction. The sales rate in the third quarter was about 6.5 million units; for the four 10-day periods now available for the fourth quarter, the rate has fallen to 5.9 million units. The production cutbacks for the fourth quarter now amount to about 75,000 units; further moderate cutbacks (there isn't much more time to cut back fourth-quarter schedules) are likely to persist. The sales rate is now so low that inventories of dealer stocks appear to be rising --- not an unusual occurrence in the fourth quarter, when production normally builds up faster than sales, but apparently unintended this time by the companies themselves, and therefore suggestive of further curtailment.

In September, if the figures can be believed, business inventories rose very sharply --- at a $60 billion annual rate. Very little of this current-dollar increase can be attributed to prices, since the the rate of price change in September was very small. To the extent that these still very tentative indications deserve credibility, they suggest that inventories were growing unsustainably, and unintendedly, at the beginning of the fourth quarter, a conclusion that suggests curtailment of production schedules to arrest the growth in inventory. The TSL model called for zero change in business inventories in the fourth quarter. To achieve that now would require either a very improbable surge of final demand, or a curtailment of output to arrest accumulation.

The Case Against Christmas

The retail trade figure for October, in current dollars, was almost precisely at the third-quarter level; the model called for a very slight decline. However, the behavior of the automobile market alone would suggest that aggregate retail trade in November will be no higher than the October figure, and probably lower. Whatever happens to retail trade in

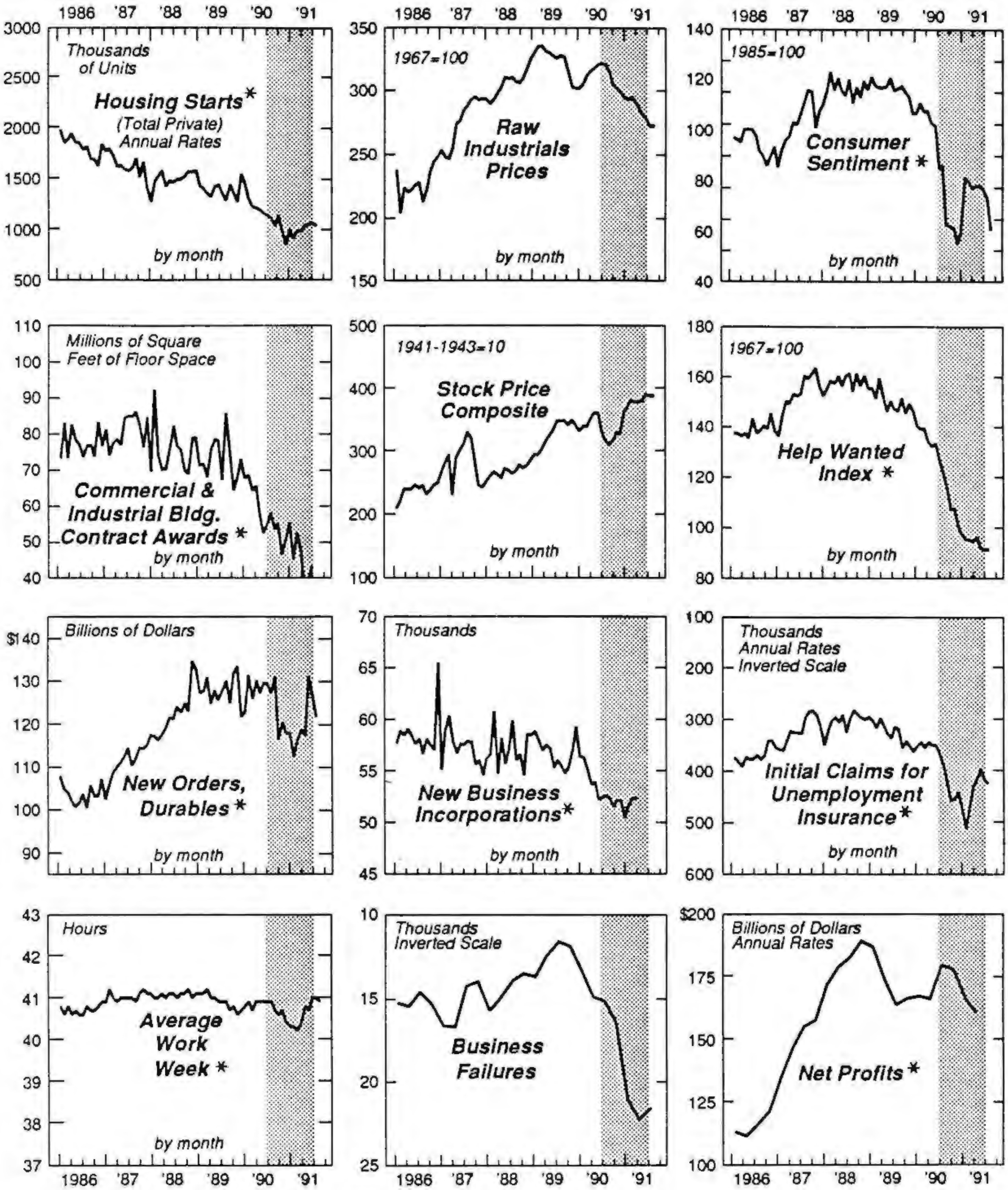
October and November can only be an augury of what will happen in the crucial month of December; it is early to write Christmas off as a zero change from a year ago, but that is the present indication of the figures. Consumer attitudes, as revealed in both The Conference Board survey and the survey of the University of Michigan, have clearly deteriorated further, lending further probability to a weak Christmas trade. The rise in the seasonally adjusted weekly unemployment figures for early November reinforces that probability.

Finally, the statistics on prices have provided an immense volume of noise in the statistical price outlook, but really no significant change. The very rapid rise of the producer price index for October should probably be treated as an enormous abnormality, partly reflecting abnormal weakness in a few preceding months, and perhaps also an abnormal seasonal adjustment dilemma. <u>The rise should not be taken as anything even distantly resembling a general onset of renewed inflation; the bond market's uneasy reaction to the figure was typical, predictable and meaningless</u>. The day after the producer price index showed so large a gain, the consumer price index showed virtually no change at all (and the bond market recovered). The monthly CPI deserves no more respect than the monthly producer price index, but in this environment it is clearly much closer to the realities of price behavior than the producer price index.

<u>The Subsiding Consensus</u>

What to make of all this? The consensus measured by <u>Blue Chip Economic Indicators</u>, a highly regarded regular tabulation of over 50 published forecasts, is clearly subsiding. The estimate for real output in 1991 as a whole has dropped a little further, to minus 0.4 percent. And

Twelve Sensitive Business Indicators



* Seasonally Adjusted Note: Shaded areas indicate recessions

Sources: U.S. Department of Commerce; F.W. Dodge; U.S. Department of Labor; Commodity Research Bureau, Inc.; Standard & Poor's Corporation; National Bureau of Economic Research; Dun & Bradstreet; *The Sommers Letter* the forecast for 1992 as a whole has fallen from about 2.7 percent in October all the way down to 2.4 percent in November. (The TSL model shows minus 0.5 percent for 1991, and plus 1.9 percent for 1992). All of these figures should be compared with a minus 0.2 percent in the forecast of the Bush Administration for 1991, and plus 3.2 percent for 1992. The small difference in outlooks for 1991, of course, reflects the fact that most of the year is over. But the sizable difference for 1992 is quite significant, particularly in that forecasters are calling for a lower economy, and therefore lower tax revenues, than the Administration still credits in its own budget account. This, in turn, suggests a still further widening of the cyclical budget deficit in the fourth quarter of 1991, as described in Letter 91-29.

<u>What to make of all this? There is simply too much general weakness in the oncoming data to support an optimistic view of Christmas trade, and of general economic conditions into the first quarter of 1992</u>. The evidence of deterioration in this recovery, if that's what it is, is considerably more impressive than it was even two weeks ago. This Letter has stuck doggedly to the proposition that no "double-dip" --- that is, no renewal of actual recession --- should yet be assumed. The Letter sticks with this view, but now nervously; a renewal of recession can no longer be ruled out categorically. Its probability coefficient has risen enough to require some degree of consideration. Of all of the figures bearing on this issue, the most significant may well be the turn into substantial inventory accumulation in September, for the first time since last November; the figures suggests <u>involuntary</u> accumulation of inventory in September, and no thrust at all from intended inventory growth in the fourth quarter of this year.

This condition obviously adds to the pressure on fiscal policy to take a hand. It can be argued very persuasively that the destruction of liquidity and of asset valuations now occurring in the aftermath of the great debt cycle of the 1980's has been neutralizing the Federal Reserve's capacity to restore a credit environment conducive to renewed growth in lending and borrowing. The trouble, as these **Letters** have argued, is not that the Federal Reserve's efforts have not been substantial; note declines of interest rates of 200 to 300 basis points, and a discount rate and a Federal funds rate lower than at any time in a decade-and-a-half. In particular, the Letter has argued that a budget deficit approaching 6 percent of GNP this year is not really stimulative and may conceivably be restrictive, because of the direction of the outlays; RTC has been described in the **Letters** as actually a negative influence on real growth. (In a commendably strong article in the Wall Street Journal of November 13, Kurt Richebacher quite properly goes further. He describes the RTC operation as "akin to a massive contractionary open market operation").

Perhaps very regrettably, because of the existing size of the deficit requiring financing, some degree of fiscal intervention grows more necessary, and clearly more probable. For those who are reconciled to this conclusion, the sooner would certainly be the better. But it is likely to be several months before any real efforts of fiscal action will be available. In the meantime, continued cautious, conservative planning remains in order.

TSL the sommers letter
since 1980
continuing appraisal of the financial, industrial and policy outlook

November 4, 1991
91-28

Big Questions, Uncertain Answers

- Signs of growth out there are actually diminishing; it is now a pretty good guess that the growth rate in the fourth quarter will actually be lower than in the third quarter --- maybe almost zero --- and that total output for 1991 will be about 0.6 percent below 1990.

- Pressure on the Federal Reserve to do more grew irresistible last week, both because of subsidence of the growth rate in recent months, and because its failure to act would add an undesirable frenzy to the growing debate on fiscal policy.

- Is the budget deficit, growing as it is, really all that stimulative? No, not at all. The growth in expenditures is predominantly in money flows that have little or no impact on the real world of demand and supply. The pressures to "do something" fiscally are getting hard to resist, particularly in an election year. There are good and bad ways of applying fiscal policy to the current situation; a number of ideas, directed at real markets --- real supply, real demand.

- Fiscal stimulation --- it has to be modest --- need not cost the budget or the debt figures very much at all, since their proper moderate application would obviate further declines in Federal revenue that would occur in their absence, and the real stimulation would produce incremental revenues.

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In plain words, business out there is really pretty bad. The labor market is still being jolted by substantial structural layoffs. The government sector, which accounts for 20 percent of all demand, is subsiding both in terms of employment and real expenditure. Such cyclical industries as automobiles and housing, essential to recovery, have experienced no growth in recent months, and actually now appear to be declining. The third quarter benefited from a substantial reduction in the rate of liquidation of inventory, but the conditions required to precipitate accumulation of inventory are missing virtually totally, which means that the fourth quarter is unlikely to benefit much from further strength in inventory demand.

This may not mark a return to recession; The Sommers Letter doesn't think so. But it must be said that this is no longer a recovery bearing any resemblance to previous recoveries. Recessions are supposed to build strength for the future, however unpleasant they are as they proceed; but almost all the presumptive strength arising out of the 1990-1991 recession now appears to have been dissipated, and is simply not available to the next few quarters.

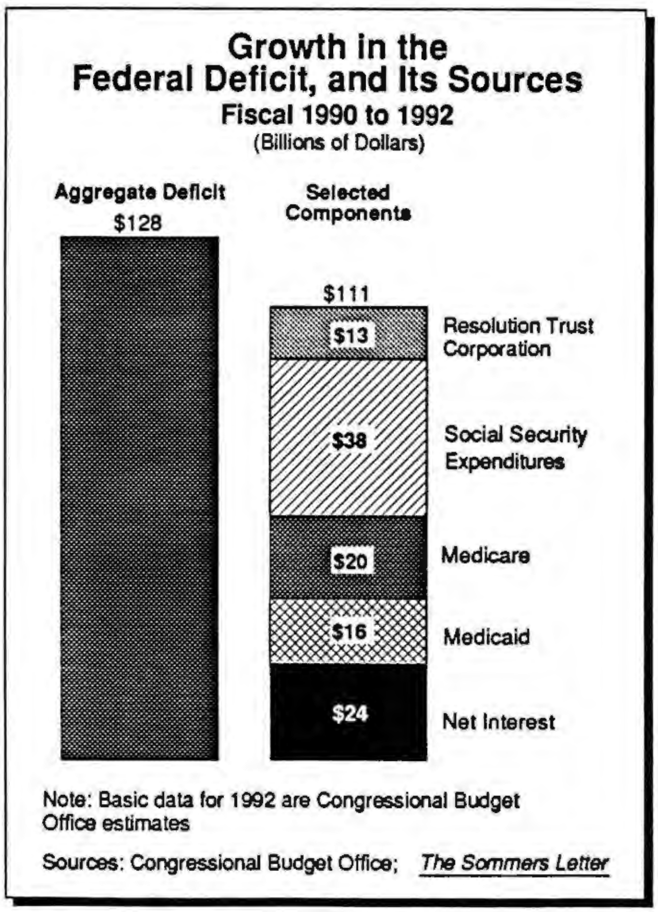
Let's say that this is drift, at a level not significantly improved from the bottom of the recession. And all of this has occurred in the presence of what would have been called, many years ago, an explosive policy combination of huge budget deficits and Federal Reserve policy sufficiently accommodative to have produced a major decline in rates. The pressures on the Federal Reserve to apply more of its own remedies grew irresistible because of its implied commitment to economic activity, and because policy considerations are unquestionably turning toward what can be done by fiscal policy. The Federal Reserve doubtless has mixed feelings about the mounting debate over fiscal stimulus: the turn to fiscal policy marks a disappointed reappraisal of the power of monetary policy to produce the results that the Federal Reserve itself, and Fed-watchers, have always assumed resided in its powers.

The TSL explanation for the quandary of the U.S. economy toward the close of 1991 remains unchanged: the blanket of debt, and the overhang of long-lived assets inherited out of the uncontrolled explosion of the 1980's, is fully offsetting the power of the business cycle to reassert growth after recession. This is cause; the puzzling trend of money and credit is consequence. The condition out there is spectacular testimony to what the 1980's did to the ordinary self-correcting processes of the U.S. operating statement; it is drowning out those processes through the distorted balance-sheet consequences of a half-decade of undisciplined and over-stimulated departures from ordinary business history.

This Letter remains very satisfied with this explanation of the present quandary. But explanations, however satisfying intellectually, are no substitute for action, a conclusion that the Congress is already reaching, and which the Administration must certainly begin to consider. Even the guarantee systems forged to protect the U.S. economy from serious noncyclical weakness are under enormous pressure; the FSLIC is gone, replaced by RTC; the FDIC itself is in trouble; so is the Pension Benefit Guarantee Corporation; so is the unemployment insurance system; so is Medicaid.

So it is hardly surprising that attention is focusing ever more intensely on fiscal policy, and what its contribution can now be. Even in the presence of a budget deficit reaching back toward 6 percent of GNP in fiscal 1992, there is no escape from careful evaluation of what fiscal policy can now do.

In fact, close examination of the sources of the growth in the budget deficit (see chart below) suggests that much of it is nonstimulative, and some aspects of it are actually contractionary. Previous **Letters** have pointed out that RTC, which will account for $43 billion of the budget deficit in fiscal 1992, is not at all stimulative, since it simply restores to individuals, through the guarantee of bank accounts, what they never doubted they owned in the first place; it simply represents a transfer of the liability side of their financial assets from the private banking system to the government. Moreover, the accumulation of all those long-lived assets now in the inventory of RTC overhangs both the residential and nonresidential components of that market, constraining activity in both sectors, and weakening the market value of the existing assets.



Note: Basic data for 1992 are Congressional Budget Office estimates

Sources: Congressional Budget Office; *The Sommers Letter*

The impending decline in defense, while it may in some future date contribute a "dividend" available for other purposes, is now mainly precipitating anticipatory reductions in activity in large parts of the defense production industry. For the time being, it is the shadow of the coming decline in defense, not its ultimate actuality, that is affecting employment and production schedules in that major industry. In 1991, real outlays of the Federal government appear to have risen 0.5 percent. In 1982, in the last year of a tough recession, they rose 5 percent.

Where's The Fiscal Stimulus?

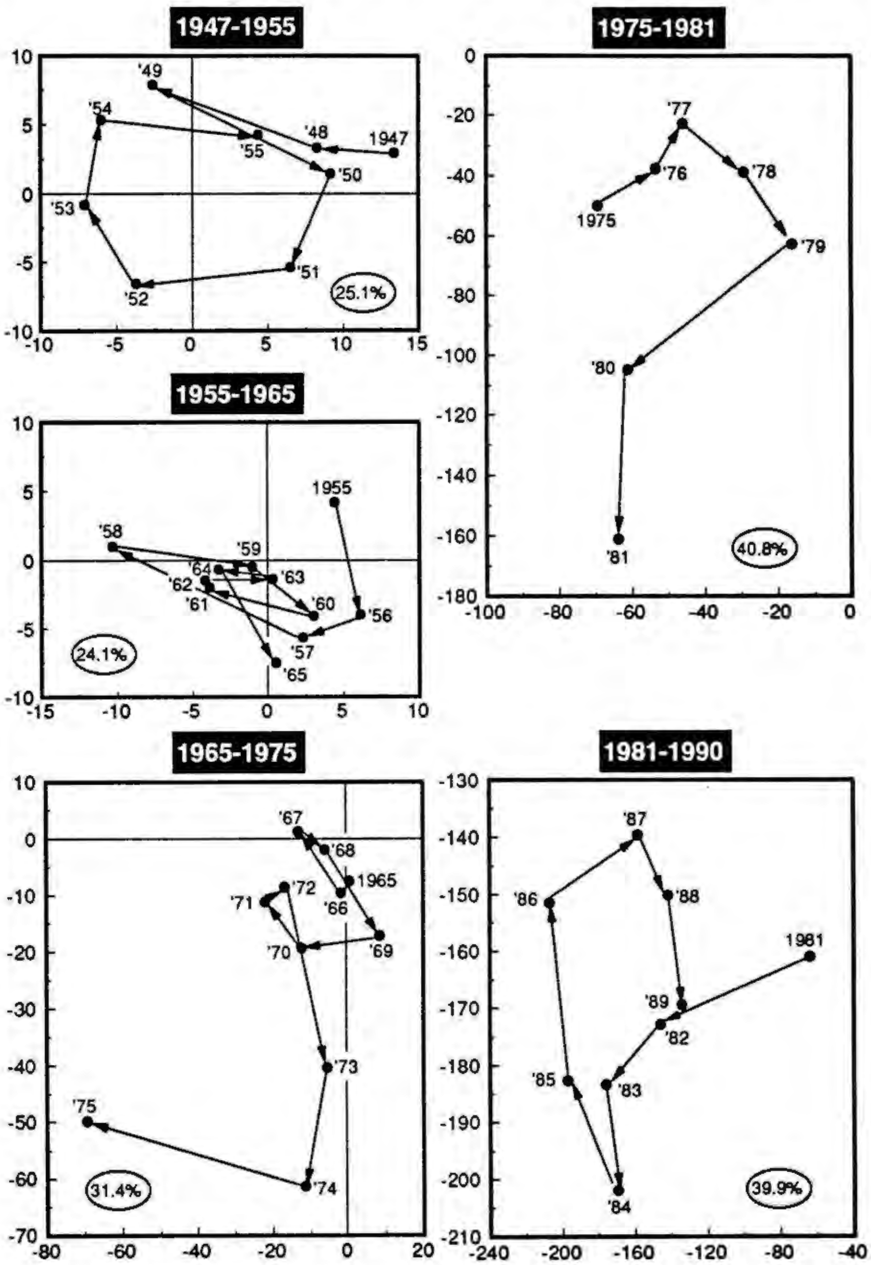
Other aspects of the rise in spending suggest little or no stimulus. The growth in Medicaid outlays can hardly be called stimulative. Total transfer payments from the Federal budget have grown massively over the past year, but much of those payments bypass the central sectors of the household market responsible for discretionary spending. Personal contributions for social insurance have continued to rise, albeit moderately. Personal dividend income is unchanged in 1991, and personal interest income has been declining throughout 1991, as a reflection of falling interest yields.

Even something must be said about the taxes confronting the U.S. system. Including state income taxes, the top marginal rate for most individuals must now be close to 40 percent, and even this does not include increasing resort to sales taxes and user taxes, or the considerable increase in state and local property taxes bearing on the 63 percent of the population that owns its own home. Finally, Federal outlays for investment in infrastructure, even expressed in current dollars, are no higher now than they were a year ago.

Looked at this way, governmental activity over the past year, and since the presumed "trough" of the recession in April or May, has not really provided anything significant in the way of stimulus to the real ongoing world; the growth of spending is mainly in parts of the system whose connection to real activity is dim and deferred. On the other hand, the financing of the growth of the deficit is a continuing restraint on the Federal Reserve's ability to get interest rates down, and even poses a threat that the Fed's efforts to reduce short-term rates further will not readily be transferred to the long end of the yield curve. It may seem paradoxical to argue that a budget deficit rising at the rate at which it is now rising carries no real growth consequences, while the financing of the deficit represents some burden on growth through its real or threatened effects on interest rates. But this is now a very credible proposition. There is simply no part of government outlay in the United States --- real government outlay, not transfers --- that is contributing to the growth of real aggregate business. The digestion of the excesses of the 1980's is being confronted, and its consequences limited, by the displacement of private debtors by public debtors, but no net growth is occurring anywhere in the government sector. Indeed, the chart on page 6 suggests that budget deficits in general have grown much less stimulative, and much less self-correcting, as the composition of outlays has shifted away from real purchase and toward transfer-type spending.

What to do? First of all, policy has to accept the fact that there is now an important role for fiscal measures intended to support and then augment real economic activity in the private sector; and that such measures, to the extent that they are effective, will be relatively costless because their consequences will yield higher tax revenues in calendar 1992 than would otherwise be the case. The conventional segregation of the budget deficit into a "secular" component, representing

The Deteriorating Tendency of Federal Budget Deficits to be Self-Correcting



Percentages shown in each chart segment represent Transfer Payments as a Percent of Total Federal Outlays.

Note: Actual Budget Surplus or Deficit, "x" axis; Average Surplus or Deficit over the next two years, "y" axis.

Sources: U.S. Department of Commerce; *The Sommers Letter*

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a mismatch of expenditures and revenues, and a "cyclical" component, measuring the consequences to the deficit of a cyclical shortfall in economic activity, has until recently suggested that all of the deficit was "secular"; that is, that business conditions were proceeding at approximately a normal, moderately prosperous level. That assumption is now clearly incorrect; a significant cyclical deficit has developed in the Federal budget, and it behooves policy to move to arrest that component of the deficit, through cyclical stimulation. In Keynesian logic, which is still dependable at least in this respect, the control of the cyclical deficit is a legitimate target of policy, and it costs very little because the resulting stronger economic activity will pay itself off in part through higher revenues, and maybe even reduced emergency outlays such as those experienced by RTC and the unemployment insurance system. (Of the $227 billion increase in the estimate of the 1992 deficit between the estimate of January 1990 and the estimate of August 1991, $63 billion is attributable to a decline in estimated revenues, which in turn reflects downward revisions in the estimates for aggregate economic activity.)

Policy Choices, Good and Bad

The appropriate range of policies to examine, in the light of these objectives, includes policies that will increase spending in the private sector. Savings incentives are not directly in point, and in any event they are not effective. A reduction in the capital gains tax may be useful in the long run, but it has no bearing at all on short-term conditions. Increased tax exemptions for households with children is too selective, and too delayed in its consequences. Some modest degree of broad personal tax reduction, which would be effective in withholdings at the beginning of 1992, offers some promise. An investment tax credit, legislated for a two-year period, beginning January 1, 1992, perhaps designed to provide the credit only to incremental capital outlay above a rate prevailing in a base period, might well be an effective stimulant to plant and equipment outlay, which is likely to go nowhere under present economic conditions. A temporary reduction of Social Security tax withholdings would likewise have a prompt reflection in paychecks. And proposals to investigate how best to support and stimulate the infrastructure outlays of state and local government, in ways that would have reasonably prompt responses, should also be explored.

Such measures, and others like them, represent deliberate countercyclical stimulus on the part of the Federal government. They would inevitably add to short-term calculations of where the Federal budget deficit is going, and for that reason would exert an initial upward pressure on interest rates, particularly long rates. The Federal Reserve can help to resist this undesired side effect by openly supporting the fiscal measures, and disavowing any presumed inflationary consequences.

This is not to deny that the fiscal position of the United States is a quandary that will require long-term treatment. Whatever proposals are finally undertaken should be done in moderation, and with frequent reappraisal of the need, as indicated by the evolving statistics on the behavior of the business system. But it takes a long time to draft, legislate and install such stimulative devices, and it would be encouraging to the whole system to tune in promptly on an intelligent debate on assistance from the public sector. In the absence of such a sense of willing, moderate and intelligent response, business conditions are likely to flounder, or even to decline again, over the next six months. As it is, optimism about business conditions in late 1991 and the first half of 1992 is clearly deteriorating among consumers, businessmen and even among economists.

The **TSL** model for the third quarter of 1991 turned out to be quite precisely in line with the U.S. Department of Commerce's preliminary release of the national accounts on October 29. But a further revision is nevertheless required; it will considerably reduce the growth rate of the system in late 1991, and in the early months of 1992.

TSL the sommers letter since 1980

continuing appraisal of the financial, industrial and policy outlook

November 12, 1991
91-29

A Still Slower Model

- Aggregate business conditions remain extremely sluggish --- not declining, but growing at a rate clearly below the rate of the third quarter.

- The loss of momentum is such as to suggest that early 1992 will be no great shakes either. None of the really cyclical components of final demand --- consumer hard goods, housing, nonresidential construction, machinery and equipment other than EDP --- are gearing up for faster growth, and inventory demand is still mildly negative.

  Issues of fiscal policy have become a lightning rod, now drawing increasing attention from the Congress and the Administration, as the quadrennial political contest approaches.

- A huge confrontation is building, between the size of the budget deficit on the one hand, and, on the other hand, the growing evidence that it is not stimulative. In fact, it is now clear that a "cyclical deficit" --- a deficit attributable to the shortfall of economic activity from its normal trend --- is widening, and may now account for as much as 15-20 percent of the total deficit. A cyclical deficit is an invitation to stimulative fiscal policy. In addition, state and local governments are running a growing cyclical deficit of their own, to which they are responding with higher taxes and lower outlays --- behavior that is counterproductive with respect to economic recovery.

- Another revised model, with the revision again downward. It takes real growth for 1992 down to slightly below 2 percent, and projects an inflation rate for the year as a whole slightly below 3 percent. Its scaled-down proportions still generally resemble the predecessor model; no negative quarter, gradual reappearance of inventory accumulation, a considerable improvement in corporate earnings, reflecting fiscal measures taking hold at midyear, and a mild reappearance of strength in industrial prices in the last half of the year. Not great, but it might not even be this good without appropriate budgetary action.

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In the fourth quarter, the U.S. economy appears to be very nearly flat --- growing, perhaps, but at a rate so slow as to bear no real resemblance to business cycle recovery. The same problems that these **Letters** have described for almost a year are still present; a labor market too uneasy to support growth in either consumption or housing, and a government sector still experiencing declining employment and outlay.

This environment is considerably more sluggish than envisioned in the **TSL** model of two months ago, which was below the consensus at the time; and it is now below even the reduced model of a month ago. The attitudes prevailing among consumers and businessmen remain inconsistent with significant growth, not only in the fourth quarter but into early 1992. The reductions in interest rates over the past several months have yielded a substantially lower aggregate level, particularly at the short end of the yield-curve, where the cumulative decline now exceeds 250 points, and brought such short rates as the discount rate and the Federal funds rate, as well as the Treasury bill rate, to their lowest level in almost two decades. It would be hard to argue that the Federal Reserve has not responded almost to the full extent of its powers in struggling with a recession-level system that refuses to gather gear, and the odds on some fiscal action, as yet very unclear in its direction, have risen sharply. The odds are greatly augmented, of course, by the entry into a national election campaign.

The attached revised model wrestles with these uncertainties. In general, it declines any "double-dip" return to recession; no negative growth rate appears throughout 1992. But its performance is extremely sluggish in this quarter, and only moderately better into the spring of 1992. In the last half of 1992 growth accelerates, not to full and enthusiastic cyclical revival, but to a rate of growth moderately above the long-term potential of about 2.5 percent. Its acceleration in the last half of 1992 rests on the general assumption of fiscal action, without yet particularizing the form the action will take.

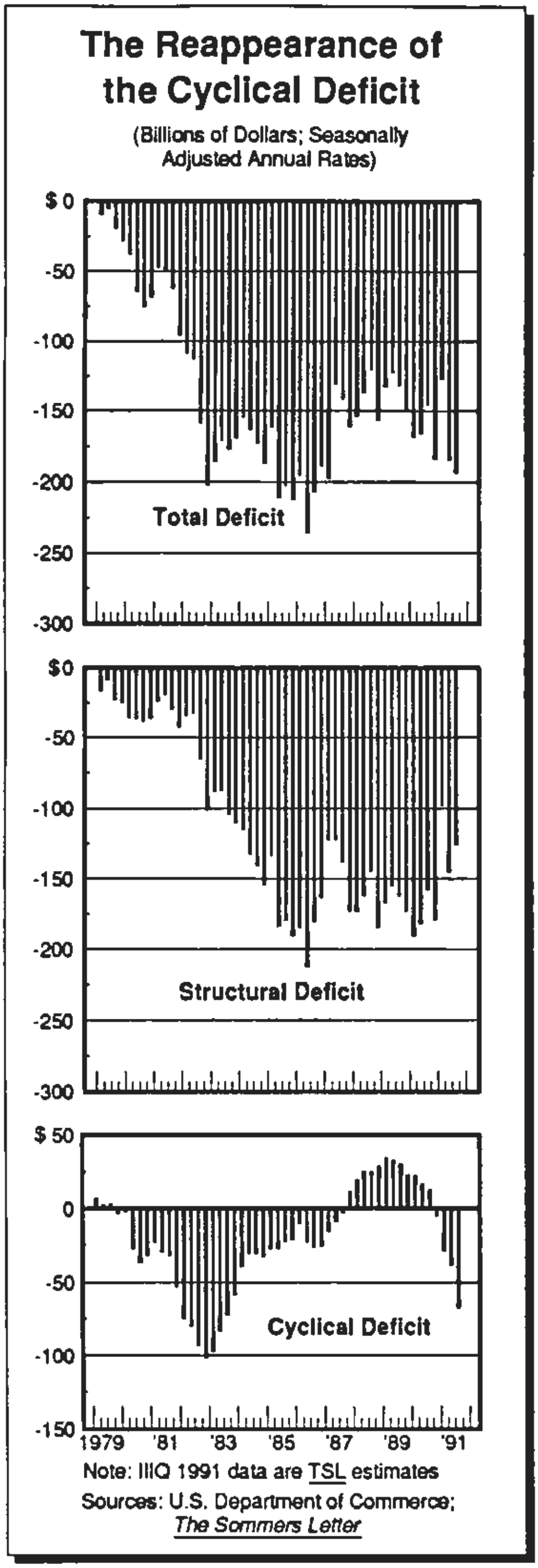
The last model significantly reduced the expected inflation rate in 1992; this model reduces it somewhat further, to close to the lowest level in decades. The inflation rate of 1992 implies a considerable further lowering in the inflation rate among services; it does not call for deflation among goods industries, and in the last half of the year it reflects the beginnings of improvement in industrial prices --- sufficient, combined with continued improvement in industrial productivity, to permit a significant but still not fully cyclical recovery of corporate earnings. If no fiscal actions were to occur, the growth rate in the last half of the year would be at least moderately lower than appears in the model, and the aggregate annual growth rate of slightly less than 2 percent would be about 1.5 percent. Under such conditions, the aggregate compound growth rate from 1988 to 1992 would be less than 1 percent --- the lowest four-year compound growth of any such period in the postwar years.

Fiscal Measures And The Deficit

The immense size of the budget deficit --- nearing 6 percent of GNP again in the current fiscal year --- stands as a great obstacle to fiscal stimulus through either tax reduction or increased outlay. Prior Letters have described the degree to which the existing deficit, and specifically the increase in the deficit this year, consists entirely of growth in financial flows that have little bearing on real economic activity. The control of the deficit in the future is an obvious necessity confronting policy; but so is a resumption of growth in the economy. The underperformance is exaggerating other great long-term problems --- underemployment, welfare costs, education inadequacies, crime, drugs. In the presence of unsatisfactory economic performance, all of these issues are congealing into a social and cultural dilemma that will get loads of attention in the oncoming election campaign.

A "Cyclical Deficit" Again

The long slack in the U.S. system is generating a "cyclical deficit" as a component of the total. The "structural deficit", generated by a mismatch of revenues and expenditures, is now being enhanced by incremental governmental expenditures associated with a sluggish economy, and the losses of revenue resulting from a failure of the tax base to grow. The accompanying chart on page 4 discloses the reappearance and now substantial growth of this cyclical component of the deficit. It should be borne in mind that the separation between "structural" and "cyclical" is a statistical procedure; it takes much of its significance from the statistical techniques by which the separation is made. Right now, the cyclical deficit is calculated on the assumption that a 6 percent unemployment rate represents normal, moderate prosperity. This is the highest unemployment percentage ever used for the purpose; it is not just old-timers who can recall that the separation used to be based on a "normal" unemployment rate of 4 percent, and even less in the early postwar years. The use of a 4 percent unemployment rate in such a calculation would now produce a huge cyclical deficit --- perhaps as much as half of the total deficit, rather than the 20 percent share accorded to the cyclical deficit under a 6 percent unemployment assumption.



This issue of the degree of cyclical deficit embodied in the total deficit will doubtless get a great deal of attention as the fiscal debate works its way toward actual proposals. In the course of the debate it should be recalled that the great tax reductions of the early 1960's were supported by demonstrations that the small deficits of those years reflected huge structural surplus (at the wartime tax rates that still prevailed in the late 1950's) offset by a growing cyclical deficit. In the early 1960's the tax receipts at high employment would so far exceed budget outlays that the system simply could not gear itself back to high employment.

In the early 1990's a cyclical deficit is reappearing even in the presence of a large, presumably stimulative structural deficit --- testimony to how deeply depressive are the excesses inherited from the 1980's. In any event, the reappearance of the cyclical deficit describes circumstances in which fiscal stimulus would cost the system little or nothing in terms of the aggregate deficit. The return toward at least moderate prosperity would yield a considerable increase in Federal revenues, whereas the failure to return toward normal prosperity would produce a continuing enlargement of the cyclical deficit. Economists favoring a combination of tax reduction and increased spending --- not of the transfer type, but aimed directly at the stimulation of real demand and real output --- will make all of these points.

The budgeting calculations described above apply only to the Federal budget. But it is obvious that state and local governments are experiencing mounting cyclical deficits of their own, which they are dealing with by raising taxes and curtailing outlay --- exactly the wrong things to do in a system that exhibits persistent unemployment of resources.

Well that's the great dilemma, whose shadow lies athwart Washington. This time around, even more than usually, the political campaign will be brimming with the economics of the budget deficit, and its confrontation with what appear to be the real needs of the system. In 1992, these **Letters** will be on fiscal alert, weighing economic performance against the emerging probabilities of tax and spending developments.

A REVENUE OPPORTUNITY

THERE ARE THREE SOUND POLICY ARGUMENTS FOR BASING THE FEDERAL ALCOHOL EXCISE TAX SOLELY ON THE AMOUNT OF ALCOHOL CONTAINED IN THE BEVERAGE. SUCH A CHANGE WOULD:

- o REDUCE THE SOCIAL COSTS OF ALCOHOL CONSUMPTION
- o TREAT TAXPAYERS MORE EQUITABLY
- o RAISE SIGNIFICANT AMOUNTS OF REVENUE BY CLOSING A LOOPHOLE RATHER THAN RAISING INCOME TAX RATES

THERE IS ONE SPURIOUS REASON ADVANCED TO DISCOURAGE POLITICIANS FROM MOVING BEER TAXES TO THE SPIRITS RATE. IT IS THE ARGUMENT THAT BEER IS THE "WORKING MAN'S DRINK" AND THAT CONGRESS CANNOT RAISE THE TAX ON IT, OR, AT LEAST, CANNOT RAISE IT MUCH.

THIS BOOK WILL FIRST DEMONSTRATE THAT THERE IS LESS POLITICAL RISK IN ADJUSTING BEER AND WINE TAXES THAN THERE IS IN INSULATING BEER FROM FAIR TAXATION. IT WILL THEN EXPLAIN THE COMPELLING POLITICAL LOGIC IN FAVOR OF ALCOHOL TAX EQUITY.

"...BEER IS THE BEVERAGE OF CHOICE FOR THE WORKING MEN AND WOMEN OF AMERICA. A BIG TAX INCREASE ON BEER WILL MAKE LIFE TOUGHER FOR THOSE WHO ARE WORKING HARD TO MAKE A LIVING -- NOT FOR THE RICH AND POWERFUL."

SOURCE: FUNDRAISING LETTER FROM "BEER DRINKERS OF AMERICA" -- A BEER INDUSTRY-FUNDED ORGANIZATION

THE ESSENCE OF THE BEER INDUSTRY ARGUMENT IN FAVOR OF PROTECTING ITS PRODUCTS FROM INCREASED FEDERAL TAXATION IS THIS:

- MOST AMERICANS ARE LOWER AND MIDDLE INCOME TAXPAYERS WHO DRINK BEER.
- THOSE AMERICANS DESERVE TO BUY BEER AT LOW PRICES.
- THEY WILL RISE UP AS ONE AGAINST ANY POLITICIAN WHO SEEKS HIGHER TAXES ON BEER.

THIS ARGUMENT IS INCORRECT ON EVERY COUNT.

- LESS THAN 40 PERCENT OF LOW AND MIDDLE INCOME AMERICANS DRINK ANY BEER AT ALL.
- BEER DRINKERS IN EVERY ECONOMIC CATEGORY SUPPORT HIGHER TAXES ON BEER.
- AMERICANS WHO IDENTIFY THEMSELVES AS BEING IN THE WORKING CLASS SUPPORT HIGHER TAXES FOR BEER.
- AMERICANS WHO THINK BETTER OF POLITICAL LEADERS WHO SUPPORT ALCOHOL TAX EQUITY CLEARLY OUTNUMBER THOSE WHO WOULD BE UNHAPPY WITH SUCH POLITICIANS.

SOURCE: SMM 89 WGT: POP
TABLE BASE: AGE: 21+

ROW	CELL	TOTAL	DRINK ANY BEVERAGE ALCOHOL	DRINK ANY WINE	DRINK ANY DISTILLED SPIRITS	DRINK ANY BEER
HHI: $60,000+	#RESP	1579	1214	955	967	846
	(000)	18984	14639	11229	11679	10193
	VERT%	11.35	13.83	15.08	14.77	13.89
	HORZ%	100.00	77.11	59.14	61.52	53.69
	INDEX	100	122	133	130	122
	GRTOT%	11.35	8.75	6.71	6.98	6.09
HHI: UNDER $35,000	#RESP	12648	7462	4929	5323	5143
	(000)	103272	58721	38876	41929	40300
	VERT%	61.75	55.50	52.22	53.05	54.92
	HORZ%	100.00	56.86	37.64	40.60	39.02
	INDEX	100	90	85	86	89
	GRTOT%	61.75	35.11	23.24	25.07	24.09
HHI: $35,000+	#RESP	5889	4388	3318	3431	3136
	(000)	63949	47064	35566	37098	33078
	VERT%	38.24	44.49	47.77	46.94	45.07
	HORZ%	100.00	73.59	55.61	58.01	51.72
	INDEX	100	116	125	123	118
	GRTOT%	38.24	28.14	21.26	22.18	19.78
HIGHEST LEVEL COMPLETED: DID NOT GRADUATE HS	#RESP	3977	2052	1170	1384	1473
	(000)	38838	19216	10884	13139	13978
	VERT%	23.22	18.16	14.62	16.62	19.04
	HORZ%	100.00	49.47	28.02	33.83	35.99
	INDEX	100	78	63	72	82
	GRTOT%	23.22	11.49	6.50	7.85	8.35
HIGHEST LEVEL COMPLETED: GRADUATED HIGH SCHOOL	#RESP	8068	5083	3426	3725	3490
	(000)	65756	41327	28259	30609	27823
	VERT%	39.32	39.06	37.96	38.73	37.91
	HORZ%	100.00	62.84	42.97	46.54	42.31
	INDEX	100	99	97	98	96
	GRTOT%	39.32	24.71	16.89	18.30	16.63
HIGHEST LEVEL COMPLETED: ATTENDED COLLEGE	#RESP	2960	2102	1542	1603	1458
	(000)	29912	21112	15660	16302	14160
	VERT%	17.88	19.95	21.03	20.62	19.29
	HORZ%	100.00	70.58	52.35	54.49	47.33
	INDEX	100	112	118	115	108
	GRTOT%	17.88	12.62	9.36	9.74	8.46

Less than 40% of low and middle income Americans consume beer.

Roughly 52% of Americans in households earning over $35,000 drink beer.

In both categories, spirits drinkers outnumber beer drinkers

TAXES/ALCOHOLIC BEVERAGES STUDY

TABLE 15

Q.9 CONSUMPTION OF BEVERAGES IN PAST MONTH - BEER

BASE: TOTAL RESPONDENTS

		SEX		AGE					INCOME					REGION			
	TOTAL	MALE	FE-MALE	18-24 YEARS	25-34 YEARS	35-49 YEARS	50-64 YEARS	65 & OVER	UNDER 15000	15000 TO 19999	20000 TO 29999	30000 TO 39999	40000 AND OVER	NORTH EAST	NORTH CENTRAL	SOUTH	WEST
WEIGHTED TOTAL	1000	476	524	148	239	256	183	157	154	117	199	141	256	214	243	342	201
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
UNWEIGHTED TOTAL	1020	510	510	154	261	291	164	130	144	110	203	143	285	221	269	328	202
CONSUMED	377	261	116	69	115	99	60	29	39	45	91	51	106	86	114	92	85
	37.7	54.8	22.1	46.4	48.2	38.8	32.9	18.4	25.2	38.5	45.8	36.5	41.3	40.1	46.9	27.0	42.1
NOT CONSUMED	604	209	395	78	118	152	120	123	111	72	107	87	145	122	126	240	116
	60.4	44.0	75.3	53.0	49.4	59.4	65.5	78.6	72.2	61.2	53.7	62.0	56.5	57.0	51.6	70.2	57.9
DON'T KNOW/NO ANSWER	19	6	13	1	6	5	3	5	4	0	1	2	6	6	4	9	0
	1.9	1.2	2.6	.7	2.4	1.8	1.6	3.0	2.6	.4	.5	1.4	2.3	2.8	1.5	2.7	-

Only 37.5% of households with income less than $40,000 drank any beer in the past month.

TAXES/ALCOHOLIC BEVERAGES STUDY

TABLE 4

Q.4 AGREEMENT WITH STATEMENTS - THE TAX ON BEER AND WINE SHOULD BE INCREASED TO THE SAME LEVEL AS THE TAX ON LIQUOR AS A WAY FOR THE GOVERNMENT TO RAISE MONEY AND REDUCE THE BUDGET DEFICIT

BASE: TOTAL RESPONDENTS

		SEX		AGE					INCOME					REGION			
	TOTAL	MALE	FE-MALE	18-24 YEARS	25-34 YEARS	35-49 YEARS	50-64 YEARS	65 & OVER	UNDER 15000	15000 TO 19999	20000 TO 29999	30000 TO 39999	40000 AND OVER	NORTH EAST	NORTH CENTRAL	SOUTH	WEST
WEIGHTED TOTAL	1000	476	524	148	239	256	183	157	154	117	199	141	256	214	243	342	201
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
UNWEIGHTED TOTAL	1020	510	510	154	261	291	164	130	144	110	203	143	285	221	269	328	202
STRONGLY/SOMEWHAT AGREE (NET)	659	287	371	92	161	169	127	97	100	70	132	100	174	147	152	240	120
	65.8	60.3	70.9	62.4	67.5	66.1	69.2	61.9	64.9	59.8	66.5	71.3	68.0	68.4	62.5	70.3	59.5
STRONGLY AGREE	398	161	237	46	81	102	94	69	69	37	76	59	103	84	85	159	70
	39.8	33.8	45.3	31.1	33.9	39.8	51.2	43.9	44.9	31.1	38.2	42.0	40.1	39.1	34.9	46.6	34.9
SOMEWHAT AGREE	260	126	134	46	80	68	33	28	31	34	56	41	71	63	67	81	49
	26.0	26.5	25.6	31.3	33.5	26.3	18.1	18.0	20.0	28.7	28.3	29.3	27.8	29.3	27.6	23.7	24.6
NEITHER AGREE NOR DISAGREE	36	16	20	8	10	11	1	5	5	4	6	7	10	6	9	10	11
	3.6	3.4	3.8	5.6	4.2	4.5	.7	3.2	3.3	3.8	3.2	4.8	3.8	2.9	3.8	2.9	5.3
SOMEWHAT/STRONGLY DISAGREE (NET)	259	158	101	45	63	64	43	40	35	38	57	33	62	55	67	73	64
	25.9	33.2	19.3	30.4	26.6	24.8	23.3	25.8	22.7	32.5	28.6	23.5	24.2	25.6	27.4	21.5	31.8
SOMEWHAT DISAGREE	125	68	57	30	27	30	17	18	13	21	28	11	35	28	32	35	30
	12.5	14.2	10.9	20.4	11.1	11.5	9.4	11.2	8.4	17.5	13.9	8.0	13.6	12.9	13.1	10.2	15.1
STRONGLY DISAGREE	134	91	44	15	37	34	25	23	22	18	29	22	27	27	35	38	34
	13.4	19.0	8.3	10.0	15.4	13.3	13.9	14.6	14.3	15.0	14.7	15.6	10.6	12.7	14.3	11.2	16.7
DON'T KNOW/NO ANSWER	47	15	32	2	4	12	12	14	14	5	3	1	10	7	15	18	7
	4.7	3.1	6.0	1.6	1.7	4.6	6.8	9.2	9.1	3.9	1.6	.4	4.0	3.1	6.2	5.3	3.3
MEAN	3.70	3.43	3.94	3.54	3.60	3.71	3.89	3.72	3.80	3.45	3.62	3.74	3.76	3.71	3.59	3.89	3.47
STD. DEV.	1.47	1.55	1.34	1.38	1.45	1.46	1.51	1.54	1.51	1.48	1.48	1.46	1.40	1.44	1.48	1.42	1.52
STD.ERR.	.05	.07	.06	.11	.09	.09	.12	.14	.13	.14	.10	.12	.08	.10	.09	.08	.11

TAXES/ALCOHOLIC BEVERAGES STUDY

TABLE 4

Q.4 AGREEMENT WITH STATEMENTS - THE TAX ON BEER AND WINE SHOULD BE INCREASED TO THE SAME LEVEL AS THE TAX ON LIQUOR AS A WAY FOR THE GOVERNMENT TO RAISE MONEY AND REDUCE THE BUDGET DEFICIT

BASE: TOTAL RESPONDENTS

		WORKING CLASS AMERICAN		OCCUPATION	DRINKING BEHAVIOR	
	TOTAL	YES	NO	BLUE COL-LAR	TOTAL BEV-ERAGE ALCO-HOL	BEER ONLY
WEIGHTED TOTAL	1000 100.0	843 100.0	147 100.0	262 100.0	561 100.0	86 100.0
UNWEIGHTED TOTAL	1020	867	142	288	589	90
STRONGLY/SOMEWHAT AGREE (NET)	659 65.8	563 66.8	88 59.5	170 64.9	335 59.6	46 53.2
STRONGLY AGREE	398 39.8	333 39.5	59 40.4	99 37.7	169 30.1	19 22.6
SOMEWHAT AGREE	260 26.0	230 27.3	28 19.2	71 27.2	166 29.5	26 30.5
NEITHER AGREE NOR DISAGREE	36 3.6	27 3.1	9 6.4	10 3.9	23 4.1	0 -
SOMEWHAT/STRONGLY DISAGREE (NET)	259 25.9	218 25.9	39 26.5	73 27.9	190 33.9	39 45.2
SOMEWHAT DISAGREE	125 12.5	105 12.4	19 12.6	39 14.9	87 15.5	14 16.8
STRONGLY DISAGREE	134 13.4	113 13.4	20 13.9	34 13.0	104 18.5	24 28.4
DON'T KNOW/NO ANSWER	47 4.7	36 4.2	11 7.6	9 3.3	13 2.3	1 1.7
MEAN	3.70	3.70	3.64	3.64	3.38	3.02
STD. DEV.	1.47	1.46	1.51	1.46	1.52	1.60
STD.ERR.	.05	.05	.13	.09	.06	.17

Support for tax equity among self-described "working class."

Support for tax equity among Americans in traditional "blue-collar" occupations.

LEVEL OF AGREEMENT ON STATEMENTS CONCERNING
TAXES ON BEVERAGE ALCOHOL

The tax on beer and wine should be increased to the same level as the tax on liquor as a way for the government to raise money and reduce the budget deficit.

	March 86	July 87	June 88	Dec. 89
Strongly Agree	33%	33%	38%	40%
Somewhat Agree	24	26	28	26
Neither Agree Nor Disagree	2	3	4	4
Somewhat Disagree	18	15	11	13
Strongly Disagree	19	18	16	13

TABLE 14

Q.8 CHANGE IN IMPRESSION OF CONGRESSMAN/WOMAN SUPPORTING THE FEDERAL TAX INCREASE

BASE: TOTAL RESPONDENTS

		WORKING CLASS AMERICAN		OCCUP ATION	DRINKING BEHAVIOR	
	TOTAL	YES	NO	BLUE COL-LAR	TOTAL BEV-ERAGE ALCO-HOL	BEER ONLY
WEIGHTED TOTAL	1000	843	147	262	561	86
	100.0	100.0	100.0	100.0	100.0	100.0
UNWEIGHTED TOTAL	1020	867	142	288	589	90
MORE FAVORABLE IMPRESSION	242	196	43	59	95	10
	24.2	23.2	29.3	22.6	17.0	11.7
LESS FAVORABLE IMPRESSION	110	99	10	34	80	11
	11.0	11.7	7.1	13.0	14.2	12.2
NO CHANGE	609	516	87	162	374	62
	60.9	61.2	59.3	62.0	66.8	72.0
DON'T KNOW/NO ANSWER	39	32	6	6	11	3
	3.9	3.8	4.2	2.4	2.0	4.1

RICH OR POOR, BEER DRINKERS OR SPIRITS DRINKERS, MOST AMERICANS ARE CONCERNED ABOUT ISSUES SUCH AS DRIVING UNDER THE INFLUENCE AND UNDER-AGE DRINKING.

THIS FACT UNDOUBTEDLY CONTRIBUTES TO AMERICANS SUPPORTING THE REVENUE RAISING ALCOHOL TAX REVISION THAT EQUALIZES THE RATES FOR ALL BEVERAGES.

BUT IF SOME OTHER REVISION IS OFFERED IN THE NAME OF FINANCING ALCOHOL-RELATED SOCIAL COSTS, AND BEER IS SUBSTANTIALLY EXEMPTED FROM THIS CHANGE, THE PUBLIC IS LIKELY TO SEE THE HOLLOWNESS OF THE SOCIAL RATIONALE.

AFTER ALL, BEER IS NOT ONLY PERCEIVED TO BE THE BEVERAGE MOST OFTEN INVOLVED IN DWI AND TEEN DRINKING, IT IS, IN FACT, THE CULPRIT BEVERAGE IN BOTH INSTANCES.

TABLE 19

Q.10 BEVERAGE ALCOHOL CONTRIBUTING MOST TO CAUSING PROBLEM - DRIVING UNDER THE INFLUENCE OF ALCOHOL

BASE: TOTAL RESPONDENTS

		WORKING CLASS AMERICAN		OCCUP ATION	DRINKING BEHAVIOR	
	TOTAL	YES	NO	BLUE COL-LAR	TOTAL BEV-ERAGE ALCO-HOL	BEER ONLY
WEIGHTED TOTAL	1000	843	147	262	561	86
	100.0	100.0	100.0	100.0	100.0	100.0
UNWEIGHTED TOTAL	1020	867	142	288	589	90
BEER	179	151	27	58	103	12
	17.9	17.9	18.2	22.2	18.3	14.4
LIQUOR	103	84	17	27	52	11
	10.3	10.0	11.3	10.2	9.3	12.4
WINE	3	3	0	0	3	0
	.3	.3	-	-	.5	-
ALL THE SAME	690	588	97	177	396	63
	69.0	69.7	65.7	67.5	70.6	73.3
DON'T KNOW/NO ANSWER	25	18	7	0	7	0
	2.5	2.2	4.9	-	1.3	-

Beer drinkers agree

TAXES/ALCOHOLIC BEVERAGES STUDY

TABLE 20

Q.10 BEVERAGE ALCOHOL CONTRIBUTING MOST TO CAUSING PROBLEM - TEENAGE DRINKING

BASE: TOTAL RESPONDENTS

		WORKING CLASS AMERICAN		OCCUP ATION	DRINKING BEHAVIOR	
	TOTAL	YES	NO	BLUE COL- LAR	TOTAL BEV- ERAGE ALCO- HOL	BEER ONLY
WEIGHTED TOTAL	1000 100.0	843 100.0	147 100.0	262 100.0	561 100.0	86 100.0
UNWEIGHTED TOTAL	1020	867	142	288	589	90
BEER	505 50.5	429 50.9	72 48.9	130 49.7	303 54.1	40 46.0
LIQUOR	37 3.7	30 3.6	6 4.3	12 4.5	16 2.9	2 2.3
WINE	6 .6	6 .7	0 .3	3 1.0	3 .6	1 1.2
ALL THE SAME	427 42.7	360 42.7	61 41.7	116 44.4	230 41.0	38 44.6
DON'T KNOW/NO ANSWER	26 2.6	18 2.2	7 4.8	1 .4	9 1.5	5 6.0

Beer drinkers again agree

DRINKING HABITS OF 16-21 YEAR OLDS

The table below shows the alcohol drinking habits -- beverage consumed and frequency of consumption -- for youths 16 to 21 years old.

Percentage Distributions of Beverage-Specific Drinking Frequencies in the Past Three Months

	Outcome Category			
	4-7 times a week	2-3 times a week	Less than once a week	Never
Beer	11.07	27.43	18.57	42.93
Liquor	.85	13.57	24.48	61.10
Wine	.85	9.20	22.37	67.58

This data was published in the "Effects of Alcoholic Beverages Prices and Legal Drinking Ages on Youth Alcohol Use," Working-Paper No. 1852, National Bureau of Economic Research, Cambridge, March, 1986. It was based on the second National Health Nutrition Examination Survey (NHANES II), conducted by the National Center for Health Statistics (NCHS) between February, 1976, and February, 1980.

NOT ONLY IS BEER THE BEVERAGE OF CHOICE OF YOUNG PEOPLE, BUT ALSO THOSE TEENAGERS WHO DRINK THE MOST PREFER BEER THE MOST.

THE CURRENT TAX DISPARITY PERMITS THE BEVERAGE OF CHOICE OF YOUNG PEOPLE AND DRIVERS TO BE SUBSTANTIALLLY EXEMPT FROM TAXATION.

It is well documented that the drink of choice among American youth is beer. An analysis of drinking habits of youths demonstrates that the most frequent drinkers were eleven times more likely to drink beer than spirits or wine. Furthermore, young drinkers are very sensitive to the price of beer. A recent analysis of the effect of beer prices on the drinking habits of 16 to 21 year olds showed that an increase of 10 cents in the cost of a six-pack of beer would cause the number of youths who drink beer to fall by 11 percent.

Studies have repeatedly demonstrated that beer is the alcohol product most frequently associated with drunk driving. The 1987 Report of the President states that "...if the real excise tax on beer were at its 1951 level, an estimated 1000 fewer deaths per year would result, primarily of persons aged 15 to 21." Elimination of the tax subsidy for beer would have a direct effect on alcohol related traffic deaths and injuries among young people.

ENDING THE ALCOHOL TAX DISCRIMINATION WOULD GREATLY EXPAND PUBLIC UNDERSTANDING OF ALCOHOL AND ENCOURAGE POSITIVE SOCIAL BEHAVIOR.

There is no logical explanation for the continuation of this tax discrimination. This position was reinforced last year by more than 25 corporate CEOs in a petition to Congress calling for higher beverage alcohol taxes. In their petition, the corporate executives stated:

> ...we see no justification for the great difference between the excise taxes, per unit of alcohol content, on beer, wine and distilled spirits. Indeed, considering that beer is the standard introduction to alcohol for many youths, favored tax treatment for it appears to be socially highly undesirable.

Echoing this, the preliminary report of the Surgeon General's 1988 Workshop on Drunk Driving recommended that beer, wine and distilled spirits all be taxed at the same rate, noting "[r]esearch evidence shows that an increase in the excise tax could have the largest long-term effect of all policy and program options available to reduce alcohol-impaired driving.

PROFILE OF ALCOHOL-IMPAIRED DRIVERS

Youth and consumption of beer prior to driving are characteristics of alcohol-impaired drivers.

"A Profile of Fatal Accidents Involving Alcohol"

NHTSA Technical Report DOT HS-802 711
September, 1977
Prepared by:
U.S. Department of Transportation
National Highway Traffic Safety Administration
Accident Investigation Division

"A profile of the driver who is at an increased risk involved in a fatal accident in which he was drinking and for which he was responsible is as follows:

- a male between the ages of 20 and 35
- he tends to prefer beer to other alcoholic beverages
- (continued...)"

"Characteristics of Alcohol-Impaired Drivers"

Arthur C. Wolfe
University of Michigan
October, 1975
Society of Automobile Engineers

Abstract

This paper reports on data collected in 77 local and one national roadside breathtesting surveys. Overall one eighth of the 764,677 nighttime drivers tested had BACs of 0.05% or more, and this proportion increased substantially in the early morning hours. Analysis of some characteristics of these alcohol-impaired drivers showed that they are disproportionately likely to be male, divorced, black, in their thirities, of low socio-economic status, heavy drinkers, and traveling from a bar or tavern.

WHEN A GOVERNMENT DECIDES THAT IT IS APPROPRIATE TO IMPOSE A SPECIAL TAX ON A PARTICULAR PRODUCT SUCH AS ALCOHOL, THEN THAT TAX MUST BE APPLIED FAIRLY.

SPIRITS, BEER AND WINE PRODUCTS ALL CONTAIN ALCOHOL. A FAIR ALCOHOL EXCISE TAX REQUIRES THAT THE TAX BE CALCULATED ON THE AMOUNT OF ALCOHOL CONTAINED IN THE DRINK, REGARDLESS OF THE DRINK'S FORM OR FLAVOR.

ROUGHLY HALF THE AMERICAN PEOPLE UNDERSTAND THE FACT OF ALCOHOL EQUIVALENCE, AND A MAJORITY OF AMERICANS SUPPORT THE PRINCIPLE OF ALCOHOL TAX EQUITY.

IN FACT, "WORKING CLASS" AMERICANS OPPOSE SPECIAL TAX TREATMENT FOR THEMSELVES, AND BEER DRINKERS OPPOSE SPECIAL TREATMENT FOR BEER.

UNDERSTANDING OF EQUIVALENCE OF ALCOHOL IN STANDARD SIZE DRINKS OF DIFFERENT TYPES OF BEVERAGE ALCOHOL

Do 12 ounces of beer, 5 ounces of wine and 1-1/4 ounces of liquor have the same amounts of alcohol, or different amounts of alcohol?

	March 85	Nov. 85	March 86	July 87	June 88	Dec. 89
Same amount of alcohol	37%	59%	58%	53%	48%	45%
Different amount of alcohol	52	32	31	30	28	26
Undecided	10	10	11	16	24	30

TAXES/ALCOHOLIC BEVERAGES STUDY

TABLE 5

Q.4 AGREEMENT WITH STATEMENTS - THE TAX ON BEER AND WINE SHOULD BE INCREASED TO THE SAME LEVEL AS THE TAX ON LIQUOR, IN ORDER FOR FEDERAL TAXES TO BE FAIR TO THE CONSUMERS OF THE THREE BEVERAGES

BASE: TOTAL RESPONDENTS

		WORKING CLASS AMERICAN		OCCUP ATION	DRINKING BEHAVIOR	
	TOTAL	YES	NO	BLUE COL-LAR	TOTAL BEV-ERAGE ALCO-HOL	BEER ONLY
WEIGHTED TOTAL	1000 100.0	843 100.0	147 100.0	262 100.0	561 100.0	86 100.0
UNWEIGHTED TOTAL	1020	867	142	288	589	90
STRONGLY/SOMEWHAT AGREE (NET)	676 67.6	571 67.7	96 65.5	168 64.3	345 61.4	43 50.6
STRONGLY AGREE	396 39.5	332 39.4	57 38.9	96 36.6	179 31.8	25 28.8
SOMEWHAT AGREE	280 28.0	238 28.3	39 26.5	72 27.7	166 29.6	19 21.8
NEITHER AGREE NOR DISAGREE	54 5.4	46 5.4	8 5.7	17 6.3	36 6.4	2 2.3
SOMEWHAT/STRONGLY DISAGREE (NET)	219 21.9	186 22.1	32 21.6	65 24.8	162 28.8	38 44.4
SOMEWHAT DISAGREE	108 10.8	89 10.5	19 12.9	31 11.9	79 14.2	15 17.0
STRONGLY DISAGREE	111 11.1	97 11.5	13 8.7	34 13.0	82 14.7	24 27.4
DON'T KNOW/NO ANSWER	52 5.2	41 4.9	11 7.2	12 4.6	19 3.3	2 2.7
MEAN	3.78	3.77	3.80	3.66	3.51	3.08
STD. DEV.	1.39	1.40	1.36	1.43	1.45	1.64
STD.ERR.	.04	.05	.12	.09	.06	.18

Q.7A AGREEMENT THAT TAXES ON BEER SHOULD BE KEPT LOW TO BENEFIT WORKING CLASS

BASE: TOTAL RESPONDENTS

		WORKING CLASS AMERICAN		OCCUP ATION	DRINKING BEHAVIOR	
	TOTAL	YES	NO	BLUE COL-LAR	TOTAL BEV-ERAGE ALCO-HOL	BEER ONLY
WEIGHTED TOTAL	1000	843	147	262	561	86
	100.0	100.0	100.0	100.0	100.0	100.0
UNWEIGHTED TOTAL	1020	867	142	288	589	90
YES	282	244	36	91	202	39
	28.1	28.9	24.6	34.8	36.0	45.5
NO	661	554	101	155	341	44
	66.1	65.7	68.9	59.2	60.9	51.7
DON'T KNOW/NO ANSWER	57	45	10	16	17	2
	5.7	5.4	6.5	6.0	3.1	2.8

LEVEL OF AGREEMENT ON STATEMENTS CONCERNING TAXES ON BEVERAGE ALCOHOL

The tax on beer and wine should be increased to the same level as the tax on liquor, in order for federal taxes to be fair to the consumer of the three beverages.

	March 86	July 87	June 88	Dec. 89
Strongly Agree	33%	30%	36%	40%
Somewhat Agree	25	29	28	28
Neither Agree Nor Disagree	3	4	5	5
Somewhat Disagree	18	16	13	11
Strongly Disagree	17	16	15	11

ALCOHOL TAX EQUITY AT THE CURRENT SPIRITS RATE WOULD RAISE THE TAX ON A CAN OF BEER BY A VERY TOLERABLE 7 AND 1/4 CENTS.

YET EQUITY WOULD RAISE $24 BILLION OVER THE NEXT FIVE YEARS -- MORE REVENUE THAN ANY OTHER COMMONLY CONSIDERED ALCOHOL TAX PROPOSAL. FOR EXAMPLE, ALCOHOL TAX EQUITY WOULD RAISE MORE REVENUE THAN A DOUBLING OF THE CURRENT TAX RATES ON EACH BEVERAGE CATEGORY.

EQUITY ALONE RAISES ENOUGH MONEY TO RESTORE A PERSONAL IRA DEDUCTION FOR ALL AMERICANS.

FEDERAL EXCISE TAX REVENUE ESTIMATE

Beer and Wine Rates Increased to Spirits Level ($12.50 per proof gallon)

Net Revenue Gain for Fiscal Years 1991-1995: $24,019,000,000

	FY'1991	1992	1993	1994	1995
NET REVENUE GAIN, TOTAL (In $Millions)	$4,600	$4,733	$4,842	$4,868	$4,975
Spirits	$0	$0	$0	$0	$0
Beer	$3,352	$3,397	$3,421	$3,446	$3,470
Wine, Subtotal	$1,248	$1,336	$1,421	$1,423	$1,505
Table Wine	$1,084	$1,163	$1,236	$1,237	$1,308
Fortified Wine	$186	$192	$204	$204	$216
Sparkling Wine	($21)	($19)	($19)	($19)	($19)

Source: Distilled Spirits Council of the United States, Inc.

TAX CHANGE UNDER EQUITY AT THE SPIRITS TAX RATE
FOR TYPICAL SERVINGS OF BEER, WINE AND SPIRITS

	Present Tax Per Serving	Tax Per Serving Under Equity
12 oz. can of beer	2.7 cents	10 cents
5 oz. glass of table wine	2/3 of a cent	10 cents
mixed drink containing 1 and 1/4 oz. of distilled spirits	10 cents	10 cents

TAX CHANGE UNDER EQUITY AT THE SPIRITS TAX RATE
FOR TYPICAL PACKAGES OF BEER WINE AND SPIRITS

	Present Tax Per Package	Tax Per Package Under Equity
6-pack of beer	16 cents	63 cents
.750 ml bottle of table wine	3 cents	54 cents
.750 ml bottle of spirits	$1.98	$1.98

SINCE THE MID-1980S, A BROAD CROSS-SECTION OF RESPECTED POLITICAL LEADERS, BUSINESS EXECUTIVES, HEALTH OFFICIALS, AND FEDERAL BUDGET ANALYSTS HAVE ARGUED THAT AN EXCISE TAX BASED ON ALCOHOL CONTENT IS SOUND TAX POLICY.

POLICY EXPERTS RECOMMEND ALCOHOL TAX EQUITY

Since 1985, when public knowledge of alcohol equivalence increased from 37% to 59%, growing numbers of policy experts have recommended the enactment of alcohol tax equity.

The Congressional Budget Office, in 1986, 1987, 1988 and 1989 has listed alcohol tax equity among its revenue options for reducing the budget deficit.

The General Accounting Office, in November 1988, recommended tax equity on the grounds that tax rates on similar products should be equal.

In their American Agenda to President-elect Bush, former Presidents Ford and Carter recommended federal alcohol tax equity as a means of reducing the deficit.

Surgeon General Koop's December, 1988 Workshop on Drunk Driving recommended federal excise tax equalization by both federal and state governments as a step towards reducing alcohol abuse.

The Council on Competitiveness, composed of business, labor and academic leaders, recommend alcohol tax equity to President-elect Bush as a means to reduce the deficit and to assure that tax policy treats all alcohol beverages similarly.

In analyzing the economic impact of the various revenue raising options, the National League of Cities has recommended that an increase in the excise tax on beer and wine is an "acceptable" revenue raising measure.

EICKHOFF ECONOMICS
INCORPORATED

DATE: 10-29-91

TO: Roger Porter
FAX #: 202-456-2878

FROM: M. Kathryn Eickhoff
EICKHOFF ECONOMICS, INC.
Phone: 212-529-9270
Fax: 212-529-4742

We are sending 6 pages, including this page. If there are any problems with its transmission, please contact me at the number above.

Fax to Roger Porter 10-29-91

Dear Roger

Here is an op-ed piece that will appear in Thursday Wall St. Journal which I have written.

Kathryn Eickhoff

The Short and Long-term of It (Tax Policy)

M. Kathryn Eickhoff, President, Eickhoff Economics, Inc.

The political wind is up and the national climate favors a change in tax policy. The challenge is to make sure the wind blows in the right direction. At best, our economy is in a sluggish recovery; at worst, we may be slipping back into recession. In an election year, this could lead to a political bidding war and result in poor fiscal policy. In addition to the immediate cyclical problem, increased savings and investment are needed to sustain a recovery and keep us competitive in world markets. We can break out of the recession (while keeping sight of the need to reduce the federal deficit) by combining temporary, short-term, tax reduction with long-term incentives for savings and investment.

Any tax cut that really helps will be a net revenue loser in the short run. Budget neutral is cyclically neutral. However, revenue losses from a temporary tax cut would be made up over the five year budget cycle by less than a half percent higher growth in the economy. The tax cut must have substantial first year effects because monetary policy cannot help much in 1992. The Fed has done about all it can by lowering interest rates to create an environment conducive to recovery. A few more notches down over the next six to nine months is probably all that is feasible. Monetary policy needs an assist from fiscal policy to by-pass the bank credit bottleneck.

Accordingly, a new tax policy is needed, one combining temporary, short-term, tax reduction (to provide stimulus) with long-term savings and investment incentives (to improve long-term growth and competitiveness). And the short-term measures need to be in place soon to "jump-start" the recovery. A rebate on 1991 taxes could be in place by January 1, 1992, if Washington moved quickly. Refunds would start to flow in mid-January and most of the stimulus would be in place by April 15th. There would be no long-term revenue loss, such as would be associated with a permanent change in tax rates, exemptions or deductions for dependents.

How large a cut is desirable? Between 1% and 1-1/2% of GNP ($750 per household) seems appropriate. The 1975 tax rebate was 2.5% of GNP (approximately $40 billion) but it was combating a much more severe recession. Based on 1991 GNP, an effective tax cut would have to be at least $70 billion. There is no point in wasting money on a cut that is too small to do the job. The tax reduction mainly should go to lower personal taxes. However, the largest multiplier in the economy comes from stimulating equipment investment. Therefore, a temporary investment tax credit (limited to equipment in place by December 31, 1993) should be part of the plan.

Incentives For Savings

The long-term U.S. problem, the one on which it is too easy to postpone action, is too much consumption at the expense of too little savings. Total savings have declined sharply as a share of GNP over the past 10 years. In addition, the federal deficit preempts savings from uses which promote economic growth. As a share of GNP, the federal government's dissaving has grown from virtually zero in the late sixties to 3% in 1990. Even while the government was claiming more and more of the savings pie, savings rates were falling in both the household and corporate sectors. More recently, the budget problems of state and local governments have caused their contribution to savings to fall as well.

A necessary step towards improving savings and growth prospects, substantially reducing the federal deficit, was taken in the Budget Accord of 1990. This will increase the share of available savings going to the private sector. However, this is not enough. We need to increase the amount of savings in the savings pool and improve the mobility of capital.

Individual Retirement Accounts (IRAs) provide good savings incentives. There is a lot of debate about whether IRAs enhance savings or just move them around. Clearly some of both has occurred, but in the long-term IRAs must lead to new savings. Furthermore, evidence that IRAs increase savings can be seen by looking at our neighbor to the north.

Canada, has had an IRA equivalent for some time. It started small and has increased over time to 18% of income and a maximum of C$11,500. Savings in these accounts have increased more than 400% since 1983. The cumulative savings is now huge, over C$100 billion. The personal savings rate in Canada slipped only one percentage point in the 1980's, while the U.S. savings rate fell three percentage points. IRAs would help reverse our decline. IRA deductions could be tailored to the money available, increasing as the deficit declines. The deduction could be small in 1992 and 1993 when there is a short-term revenue loss from the tax rebate~~s~~, but it should be of material size, over $5000 and rising, by 1995.

The corporate sector is the largest supplier of savings in the economy, mainly through depreciation but also through retained earnings. There are a number of ways that corporate savings could be improved -- dividend deductibility and accelerated depreciation are two obvious ones. The R&D credit, which probably would be included in any bill, is less desirable because it discriminates in favor of some companies at the expense of others. The least discriminatory change would be a small reduction in the overall corporate tax rate.

It is also important that capital (accumulated savings) is used efficiently, allowed to flow to the areas with the highest returns, guided by market forces, not government edict. This is best accomplished by exempting long-term (held over two years) capital gains from tax (again one can look to Canada or our own housing capital gain exemption as examples). However, first we should gradually (1% per year) reduce the capital gains tax rate until it is well below the average personal tax rate. People will be more willing to move their capital around if the tax cost is low. If the capital gains rate is below the ordinary income tax rates, it should encourage additional savings.

The permanent enhancements to savings should be budget neutral. The necessary reductions in spending can be obtained in a number of different ways, but two stand out: accelerating the cuts in defense spending and a reduction in the government workforce. Speeding up the reduction in defense outlays will not cut spending in the short-run, because the conversion from appropriation to outlay is too slow and renegotiating of contracts will increase costs. However, it could generate significant revenue offsets over the next two to five years.

Many corporations are finding it necessary to rethink how they run their business. Restructuring, downsizing, rightsizing are the words of the day in the business sector. It is time these ideas were turned on the government sector. We need to rethink how our agencies are run, establish priorities and find ways of moving government employees into the private sector. In 1981, the Reagan administration implemented a small Reduction In Force (RIF). It is now 1991 with enough change in management techniques to warrant another RIF. If started in 1993 and gradually increased in 1994-1996, a RIF could provide another part of the sums needed to offset the short-term budget cost of the savings incentives. Those laid off would readily find jobs in an expanding economy. Inducements for early retirements could also be considered.

It is important that the Budget Accord stay in tact. However, the objective of the Budget Accord will not be achieved in an economy troubled by financial fragility which continues to move sideways. Tax reduction gave us a long expansion in the 1980s; it can do the same in the 1990s if we recognize that both our long-term and short-term requirements must be met.