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August 19, 1991

GORBACHEV'S "BLIND ALLEY"

A month ago, I sent *The New York Times* an op-ed article arguing that the "hard liners" in the Soviet Union have been right to resist the economic reforms that have been urged upon Mikhail Gorbachev by the West! On August 2, the *Times* accepted the piece, in which I wrote that "Each of the planning efforts put forward require a chaotic leap into the unknown...They all require that the old system be demolished before a new system is built...The economy continues to disintegrate as more and more Soviet citizens observe the unofficial erosion of the ruble and simply stop working. Western political leaders are understandably concerned about a further collapse of the Soviet economy as another winter draws near."

The *Times* informed me last Friday they plan to run the piece sometime before September. The Soviet "hard liners," we now see, were less patient, and Gorbachev is out of a job. In the statement reported by Tass this morning on the *coup d'etat*, the "State Committee for the State of Emergency" quite correctly observed: "The policy of reforms launched at Mikhail S. Gorbachev's initiative and designed as a means to insure the country's dynamic development and the democratization of social life has entered for several reasons a blind alley."

Financial markets around the world reacted badly, with Germany's stock market naturally taking the biggest hit. The Soviet Union is seen to be a step closer to civil war. Russian President Boris Yeltsin calls for civil disobedience. So far, though, western reporters note the people of Moscow seem strangely composed. My guess is the people see this action by the security forces as being no worse than the path they were on. There's no reasonable alternative to a temporary revival of the command economy while the political leadership figures out what to do next. With winter now only several weeks off, *the only mechanism available to the country's leaders is the central planning apparatus and the expertise of the Communist Party*, such as it is.

The initial reaction in the West was that the *coup* represents a resurgence of the Communist dictatorship *per se*. Not quite. As the text of the emergency committee indicates, the ruling power elite reaffirms its commitment to "genuine democratic processes" as well as support for "private enterprise." My belief is that these are, *at the moment*, the genuine expressions of the political establishment in Moscow. The West simply has failed in counseling a realistic transition from one system to another. Gorbachev's fatal flaw was in betting all his chips on Harvard and the seductive idea of a "Grand Bargain" of Marshall Plan proportions. The Tass statement was emphatic on this point: "Only irresponsible people can bank on some aid from abroad. No handouts can solve our problems; our rescue is in our own hands." President Bush's embrace of Gorbachev at the London Economic Summit was ultimately meaningless, a photo opportunity at the end of a blind alley. What happens next? There is only one correct solution to the USSR's transition problem, as I have been insisting for two years; it is in the text of my *NYT* op-ed:

Perestroika's Problem

Mikhail Gorbachev continues to delay the USSR's movement to a market economy, not because of opposition from "hard liners," but because each of the planning efforts put forward require a chaotic leap into the unknown.

The central problem is this: More than 95% of the nation's wealth is held collectively, the land, the housing stock and the state enterprises. Less than 5% is held by individuals in the form of claims against the state -- ruble deposits in state depositories. The debate in Moscow is not whether to transfer most of the collective wealth to private hands. That debate is over. It is how to manage the transfer, the privatization.

Everyone understands the transfer can't occur without creation of a banking system, the means by which commerce is arranged in a market economy. Neither banks nor other financial services, such as stock markets and insurance companies, exist in the Soviet Union. They've not been needed when a central apparatus has dictated the flow of resources within a framework of wage and price controls.

A banking system, though, cannot develop, either at a private curbstone level or through the network of state depositories spread across the USSR, without a convertible ruble. A marketplace cannot come into existence without a *unit of account*, a currency of known and predictable value in which contracts can be made and accounts kept.

Each of the reform plans put forth so far, including those recommended by Western economists, have a convertible ruble as an eventual target. But they all require that the old system be demolished before a new system is built. The inference is that somehow a headlong plunge into a "free market" will sort things out and the ruble will float to an unknown value that will then make it convertible.

Indeed, most Western economists seem to assume that if the Soviet government merely absents itself from economic life, a marketplace will arise as if by magic, by an "invisible hand." That is a gross error: what separates western capitalism from the law of the jungle is the *visible hand* of government in the marketplace. Government can either dictate prices, or it must provide a yardstick, a unit of account, by which individuals may set prices among themselves.

As it is, the ruble has specific meaning only within the old system, where its theoretical purchasing value is close to that of an American dollar. Outside the old system, the ruble has no value whatsoever as a unit of account and most recently traded in an Estonian auction at 77 rubles to one U.S. dollar. What value will the ruble have after a leap into the unknown?

In a country where most wealth is held by individuals, in the form of real property and financial assets tied to real property, inflation simply bails out debtors at the expense of creditors. Even in Eastern Europe there remains considerable wealth held by individuals in the form of real property. In the Soviet Union, individuals hold almost no real property or capital assets.

If the Soviet government were now to take the plunge, lifting wage and price controls and floating the ruble, almost the entire stock of capital held by Soviet citizens -- their ruble deposits -- would vanish in the ensuing inflation. The state would hold close to 100% of the wealth, its debt to its people wiped out. How will the citizenry even make the down payments to acquire state assets in the privatization process?

More critically, what happens to the economic mechanisms necessary to the daily survival of the population in the time it takes between the demolition of the old command apparatus and the creation of a banking system around this worthless ruble? These are the questions the western critics of Gorbachev's delays have failed to answer.

Yet the economy continues to disintegrate as more and more Soviet citizens observe the unofficial erosion of the ruble and simply stop working. Western political leaders are understandably concerned about a further collapse of the Soviet economy as another winter draws near. President Gorbachev has now promised a convertible ruble by January and is racing to line up western support for a reserve fund of perhaps \$8 billion in hard currencies, to support the ruble against speculators when convertibility is announced.

Critical details are still missing, though, most particularly the exchange rate at which the ruble will be made convertible. The answer lies in making the ruble worth more, not less, which the government can do by reaffirming the value of the ruble deposits held by Soviet citizens. This is a prerequisite to all other reforms. By shouldering this burden of debt itself, even guaranteeing it in gold instead of repudiating it, the state establishes the credibility of the ruble as a unit of account.

The effect on the Soviet economy would be immediate and dramatic. As soon as the Soviet state regains the confidence of the people in its currency, the economic mechanisms will work well enough to see the country through the privatization process to a market system, not to mention the coming winter.

October 25, 1991

IS PRESIDENT BUSH SERIOUS?

In his press conference this morning, President Bush once again plugged his capital gains tax cut as the key ingredient in his plans for economic growth. He asked the Congress to try it, and if it didn't work he'd take all the blame, and if it did, he'd only take half the credit. Alas, he also said he would do nothing to break the Budget Agreement, a signal to Democrats that he is not serious. Instead of reading the President's lips, they are reading Treasury Secretary Nick Brady's, who is saying a tax bill is a lousy idea and mere "political posturing." I talked last night to a Democrat who is close to the action, and he offered to cover the bets of anyone who thinks there will be a tax bill this year. The Democrats do not want one. Period. And the only way it can happen is if the President gets serious. The President cannot get serious as long as he continues to put the Budget Agreement ahead of the economy.

Theoretically, of course, the President can get the capital gains tax cut without busting the Budget Agreement. Senator Phil Gramm of Texas and House Minority Leader Newt Gingrich have teamed up on a package that meets all the administration's budget requirements. The Republicans in the House and Senate who have fought each other for the last year trying to agree on a package are now at the point of accepting the Gramm-Gingrich proposal, more or less. But it's not going to happen as long as House Ways & Means Chairman Dan Rostenkowski refuses to go along with it. The President can get nasty and jump up and down demanding the Congress send him a growth-oriented tax package. He can insist on keeping them in session until Christmas until they deliver. But they don't have to send him legislation he will want to sign. They can load up a Christmas tree of goodies that breaks the Budget Agreement, including some version of Bentsen's \$300 kiddiegrant, a puny capgains cut and a 38% tax on rich people, i.e., the median income of registered Republicans. We go around in circles once again. "All that's going on right now is a replay of last year's debate over the Budget Agreement," one of Gingrich's aides advised me this morning.

Still, there is a sense I pick up at the White House that something is happening. A few reporters I checked with, who have been skeptical, now tell me they will *not* bet against a tax bill. This is mainly because the President is more serious than the rest of his team and is becoming more alarmed at the prospect of going into 1992 with an economy still weakening. They tell me they think Darman will soon be sitting down to negotiate with Rostenkowski and Lloyd Bentsen. But I still don't think anything good will come of such talks. Darman has been talking to the Democrats for three years and has not gotten anywhere with this inside game. Only if Darman switches to an "outside" strategy can he get policy in motion. As long as he thinks the economy will grow okay without capital gains -- as Michael Boskin does -- we will go into 1992 without a tax bill. In a memo to Darman this morning I warned that "You will have a truly frightening time as budget director next spring unless you get a tax bill through before Christmas." I went on as follows:

The most critical point is that a DJIA of only 2900 is not discounting a profit stream off the nation's capital stock sufficient to lower the unemployment rate in 1992. To get the Dow up to 3400 or 3500 will be enough to do so, we reckon, and a 19.6% rate would do that. A 15% rate, unindexed, but covering all past investments in real and financial assets, would send the Dow to 4100 in short order, discounting a non-inflationary growth rate in the range of 5%. Arguments I hear around the White House that a tax bill will be inflationary fail to understand that only Fed-led expansions are inflationary in the first instance.

A 15% capgains tax, which the President promised the people in 1988, would sharply *reduce* inflationary expectations, i.e., the Fed would no longer be pressured by Brady, Boskin, and you into an inflationary policy. Remember: The 1971 breakdown of Bretton Woods occurred as the result of Nixon's doubling of the capital gains tax in 1969. Arthur Burns flooded the banks with liquidity trying to get the economy going.

If you don't get a capgains cut by year's end, it will be seen throughout the country as a failure by the Bush Administration. The Democratic contenders don't have to run against the President. They can run against his team. There are very few people who agree with me at this moment, but I believe the President will lose in 1992 unless you become fanatical on a tax bill *this year*. (A Mario Cuomo/Jerry Brown *liberal* supply-side ticket would do it.)

You're the only person in the administration who can save the economy and the President in 1992, I believe. And I don't think you can do it unless you alter your strategy, which remains the same "inside" approach you have followed without success from the first days of the administration. Instead of sitting down with Rosty and Lloyd, you have to think of the President working an "outside" strategy of your design. Develop the growth package without consulting the Democrats at all. Then have the President announce it on prime time, with the news that he will ask the Congress to stay in session until it sends him legislation he can sign. I liked the idea he threw out in his press conference this morning that Congress should try it and if it doesn't work he'll take all the blame, and if it does, he'll only take half the credit.

It is with this kind of approach in mind that I recommended to you that the President *include* in his address to the nation the concession to the Democrats of a 33% income tax on millionaires. Instead of allowing the Democrats to deal the cards, *he must do it*. If he makes the concession in the right way, following it with a call for the 15% capgains tax that he *promised the people in 1988* -- using the correct, supply-side arguments -- he will have successfully limited the negotiating room left for the Democrats. They will not be able to demand higher tax rates on millionaires, as you suggest, for they would be seen by the American people as having *upped the ante* after the cards had been dealt. Thereafter, every announcement of economic weakness or increased federal, state or local deficit will leave the President in the position of being able to bang the Democrats around at will. Knowing that, the Democrats will be in a position to compromise with you when you show up at the Rosty & Lloyd Show.

Included in the President's speech to the nation should also be a section indicating he is only making this tax concession to the Democrats because they have held this gun to his head. He should state that in 1992, he will recommend that the Republicans in Convention adopt a platform that phases out capital gains taxation altogether and brings the top rate on income to 25%. If the President would give a speech like this, covering both the economy's *immediate needs* as well as its *long-term requirements*, he would leave no running room on tax policy for the Democrats.

If the President is serious enough himself, he can of course threaten personnel changes unless his economic team gets behind a workable strategy. At the moment, for all the pretty talk from the Oval Office about a growth package before Congress adjourns, I am taking seriously the odds against it.

Jude Wanniski



LBMC file

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October 24, 1991

The Honorable Tony Snow
The White House
Washington, DC 20500

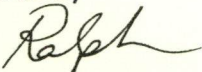
Dear Tony,

Says here in the papers that your outfit has rediscovered the existence of the U.S. economy. Thought you'd like to see Mueller's most recent speech to the National Association of Business Economists, also to the New York Society of Quantitative Analysts. It reiterates that, looking back on '92 from Reelection Day, you will be looking back on a 1992 of 3% range growth and 3% range inflation. It gives more of our analytical context.

Don't let the good news discourage you from tax reform, especially if indexing of capital gains and depreciation (which is hard to paint as a windfall to the wealthy) are part of the mix, and would moreover further help neutralize the stagflationary consequences of the reserve currency system. Nevertheless, all the tax reform proposals currently floating around amount to little more than rearranging the furniture in the house when it is the foundation -- monetary policy -- which needs a thorough overhaul. You will see a statement of our position to the policy community shortly.

Also, I had an informal conversation with a gentleman who is part of the Clinton and Kerry brain trusts, which I memoed for Bell, and send along to you, complete with editorial comments, For What Its Worth. If you share it, please do so discreetly and don't identify me as the source.

Best,


Ralph Benko



Lewis E. Lehrman
Chairman

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LBMC Report

September 1991

The World Dollar Base and Business-Cycle Forecasting

by John Mueller
Vice President & Chief Economist

Recently I wrote at length about LBMC's "Rueffian Synthesis" and showed how inflation can be broadly forecast more than two years in advance (**LBMC Report: June/ July 1991**). But the same ideas are also helpful in forecasting business cycle turning points -- further in advance than most forecasters seem to think.

In November of 1988, by combining the World Dollar Base with more conventional factors, LBMC predicted that inflation would rise sharply in 1989 and 1990, peaking between 6% and 7% year-to-year in mid-1990; and that there would be a mild recession in 1990. I'd like to explain why we thought so. And in doing so I'd like to pose the general question, "What do we know and when do we know it?" regarding inflation and business-cycle turning-points.

If LBMC has had some success in forecasting the business cycle during the turbulent last few years, I think it is

because, in addition to more conventional factors, we focus on an important aspect of the U.S. economy which is usually overlooked -- the implications of the dollar's use as international money.

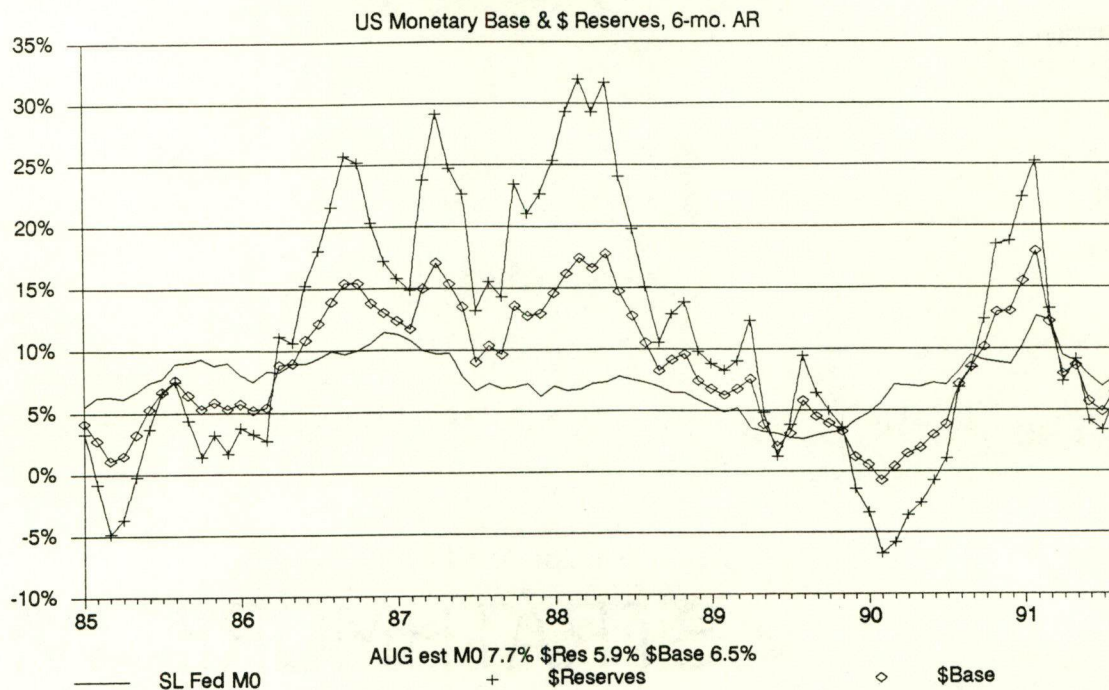
In effect, the "reserve currency" system extends the privilege of "printing money" from the national to the international stage. By its nature, using the dollar as international money is inflationary, both for the United States and for any currency tied to the dollar.

To describe the essence of the reserve-currency system I like to use a simple analogy. Imagine that everyone you met accepted your personal check. Not only that; suppose that everyone carried some of your uncashed personal checks around in their wallets instead of money.

This would have two results for your personal finance. First, you would no

GRAPH 1

LBMC's World Dollar Base



longer need to carry any money yourself -- only your checkbook. Second, when you received your bank statement every month, you would find a lot more money in your account than you had saved. The difference would be due to all the uncashed checks floating around. This arrangement would allow you to write still more checks, to finance additional consumption or investment, without being overdrawn at the bank. It would no longer be true that when you wrote a check, the other person's gain would be equal to your loss. Moreover, the supply of what people used as money would be determined by the amount of your outstanding uncashed checks.

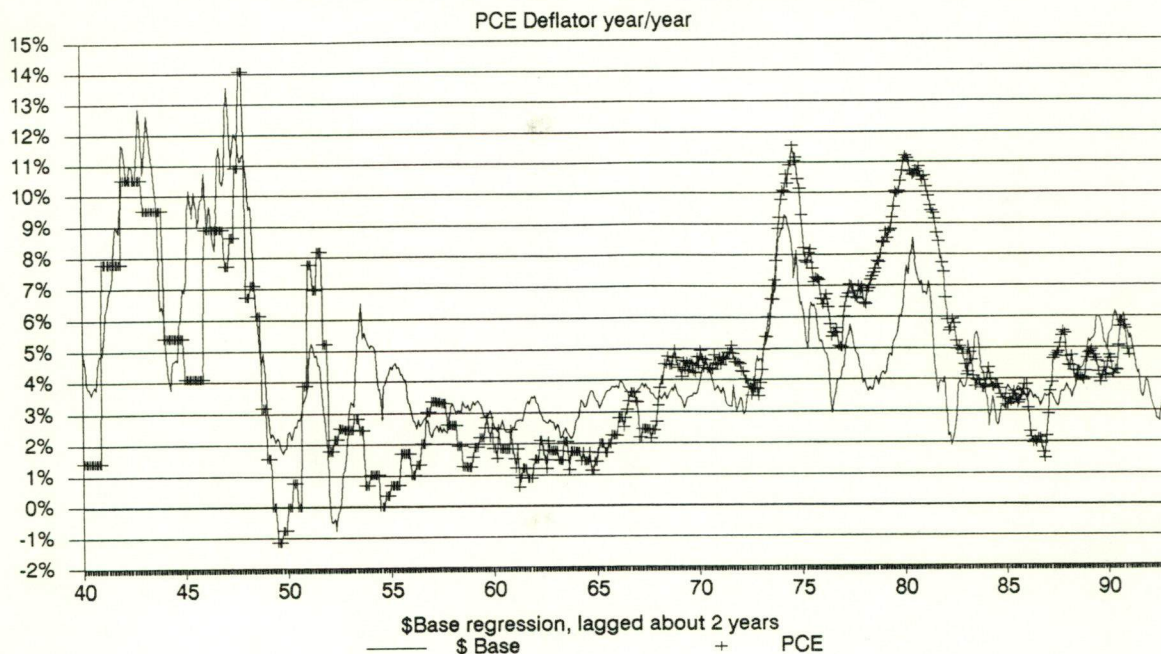
The same is true of the United States. It is supposed to be true that one country's surplus is another country's deficit. But this symmetry doesn't hold when one nation's currency is used as international money. Any increase in dollar reserves

is a net addition to dollar liquidity. If the Bundesbank stuffed its vaults with greenbacks when it bought dollars, they would be withdrawn from circulation in the United States. But this is not what happens. When the Bundesbank buys dollars, it takes those dollars out of the foreign exchange market, but immediately redeposits them in the U.S. money market by purchasing, say, a U.S. Treasury security. Germany's dollar reserves increase, but without the United States losing any of its reserve money.

The result is to add liquidity to the dollar market. And the effect is the same whether or not foreign central banks "sterilize" their intervention in their home markets, and whether or not other currencies are also used as international reserves. It is not far-fetched to consider the intervention of the Bank of England, the Bundesbank

GRAPH 2

World Dollar Base & Total Inflation



or the Bank of Japan as equivalent to open-market operations by the Federal Reserve Banks of London, Frankfurt and Tokyo.

To measure the size of the inflationary impulse in the dollar market, LBMC has constructed what we call the World Dollar Base. Our data are proprietary, but the concept is straightforward: the World Dollar Base consists of U.S. reserve money -- that is, legal tender currency and commercial bank reserves -- plus the dollar reserves of foreign central banks.

Graph 1 shows the two components of the World Dollar Base: the U.S. monetary base and foreign dollar reserves. The graph shows that the World Dollar Base often gives a very different reading of monetary policy from watching only what the Federal Reserve is doing. And when it does, we find that the World Dollar Base is giving a more accurate prediction

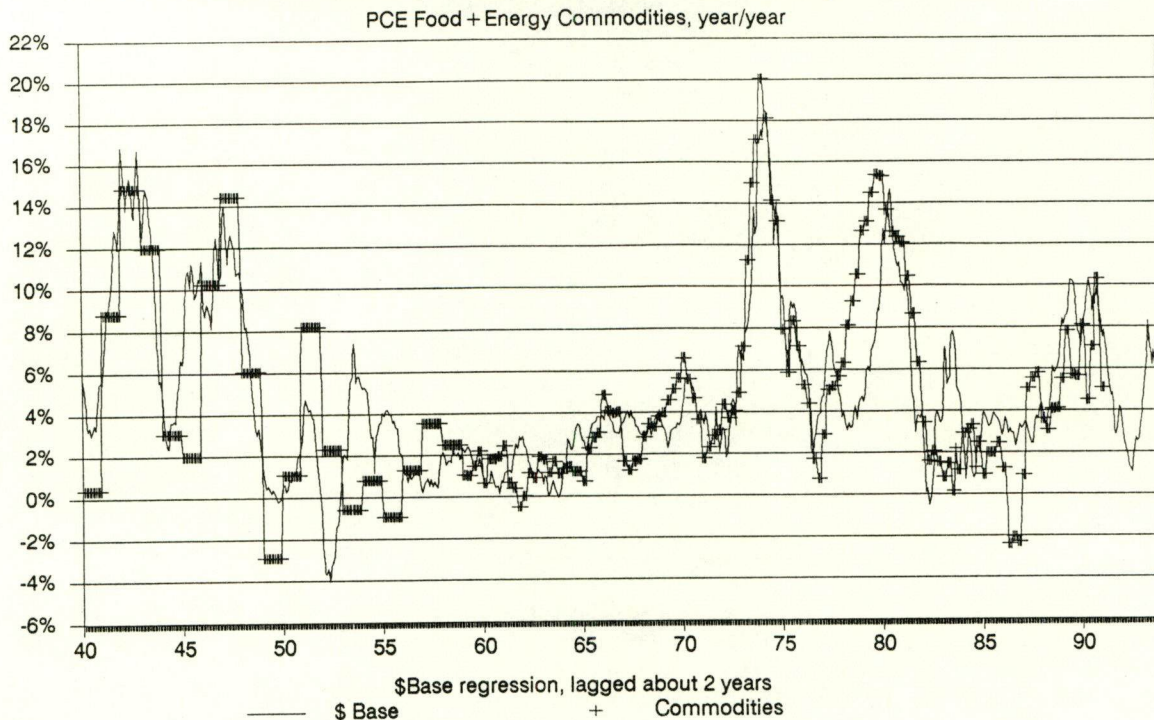
of both inflation and business-cycle turning points in the United States.

Graph 2 shows the relationship since 1940 between overall inflation -- in this case as measured by the personal consumption expenditure (PCE) deflator -- and changes in the World Dollar Base more than two years earlier. While the relationship is not perfect, it is rather remarkable that one variable can "explain" three-fifths of the inflation rate, more than two years in advance, over a span of 50 years.

However, when we look more closely, we find that the predictive power of the World Dollar Base concerns not so much inflation in general as the dollar price of tradable goods -- particularly the prices of food and energy commodities. It is customary to explain any swings in food and energy prices as due to some special event -- for example, a drought in the case of

GRAPH 3

World Dollar Base & Commodity Inflation



food prices, or OPEC policy in the case of energy prices. While these can be important at times, LBMC's research indicates that these "supply shocks" are far less important than conventional wisdom supposes.

Graph 3 shows the relationship between the growth of the World Dollar Base and food and energy commodities since 1940. Despite the fact that the prices of these commodities are far more volatile than overall inflation, the World Dollar Base has consistently predicted about three-fifths of the inflation in food and energy commodity prices over the 50-year period, again more than two years in advance. Over the past 30 years, the World Dollar Base has predicted about two-thirds of food and energy commodity inflation two years in advance. The stability of this relationship is striking when you consider the changes in exchange-rate regimes and

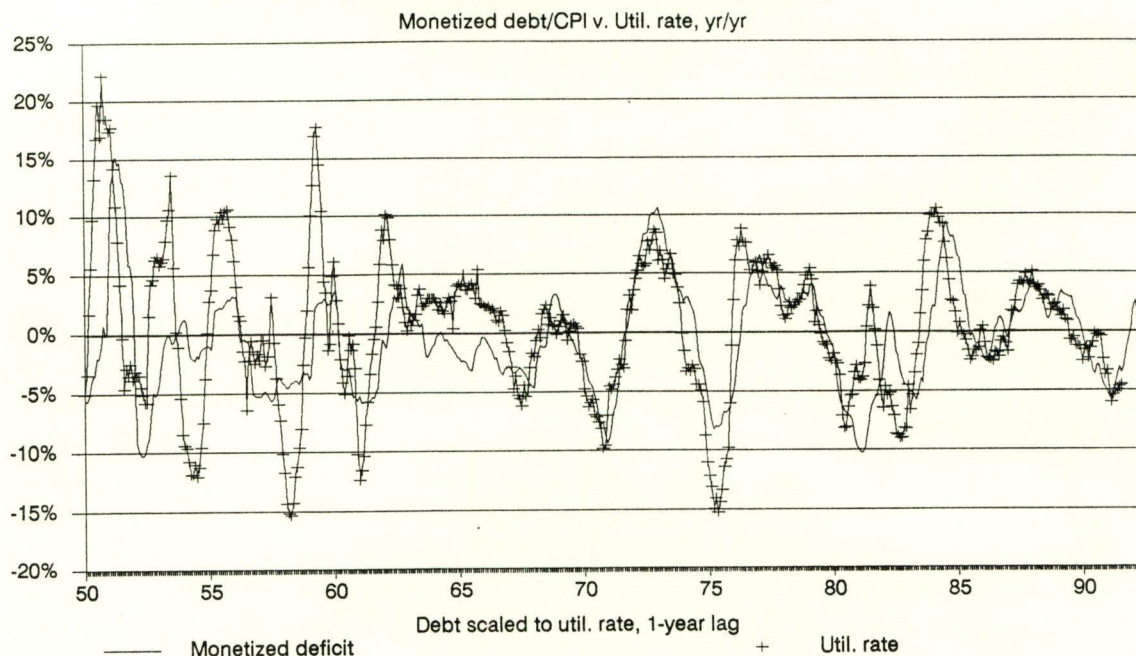
economic policy that have occurred in the past half-century.

The World Dollar Base is also helpful in forecasting so-called "core" inflation, if only because the cost of food and fuel goes into the prices of other goods. But the rest of value of the ex-food-and-energy marketbasket consists basically of labor and capital services -- either consumed directly or embodied in manufactured goods. These services are relatively sheltered from international competition, and are more sensitive to the domestic unemployment rates of labor and capital.

Graph 4 shows a simple model of overall inflation, using only data known at least two years in advance. Its chief ingredients are a forecast of commodity prices using the World Dollar Base, and a forecast of "core" inflation as a

GRAPH 5

Monetized Federal Debt & Capacity Use



excess money has been fully absorbed by a rise in the general price level.

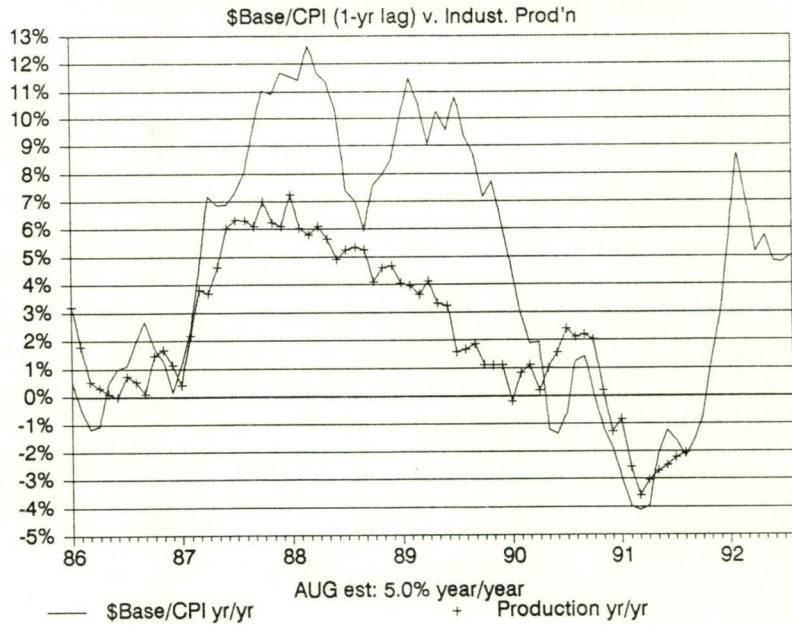
Practically speaking, most "excess" money is associated with monetizing government debt, which usually has little connection with exchanges of real wealth. Graph 5 shows that there has been a close relation between fluctuations in capacity utilization and inflation-adjusted changes in U.S. Treasury debt monetized by the central and commercial banks a year earlier.

The World Dollar Base plays a central role in the creation of excess money, because almost all of any increase in the World Dollar Base involves the purchase of U.S. Treasury securities, either by the Federal Reserve or by foreign central banks. And nowadays, most of the monetized Treasury debt is monetized by central banks.

LBMC's prediction that there would be a mild recession in 1990 was based partly on our tracking the inflation-adjusted World Dollar Base (and partly on our reading of fiscal policy). Graph 6 shows the relationship between changes in industrial production and in the World Dollar Base one year earlier. As we saw what was happening to the real World Dollar Base in 1988 and 1989, we forecast that industrial output would fall to zero at the end of 1989. Then in January 1990 we argued that there would be a "W-shaped" recession -- the first "V" in output would be followed by a temporary rise in mid-1990, followed by a second, deeper "V" in the second half of 1990. At the end of 1990, we argued that the recovery should begin in the second quarter of 1991, and be stronger than expected by the consensus at the time. Obviously we didn't predict the war with Iraq, but the recession began before the war and would have occurred without it.

I said that "excess money" leads business-cycle turning points by about one year. But, as Graph 7 shows, "excess money" itself can be broadly predicted the better part of a year beyond that, by observing the behavior of central banks. This allows us to make a fairly educated guess about the rate of unemployed labor and capital resources -- and broadly speaking, whether we will be in recession or recovery -- almost two years in advance (Graph 8).

GRAPH 6
LBMC's World Dollar Base & Output

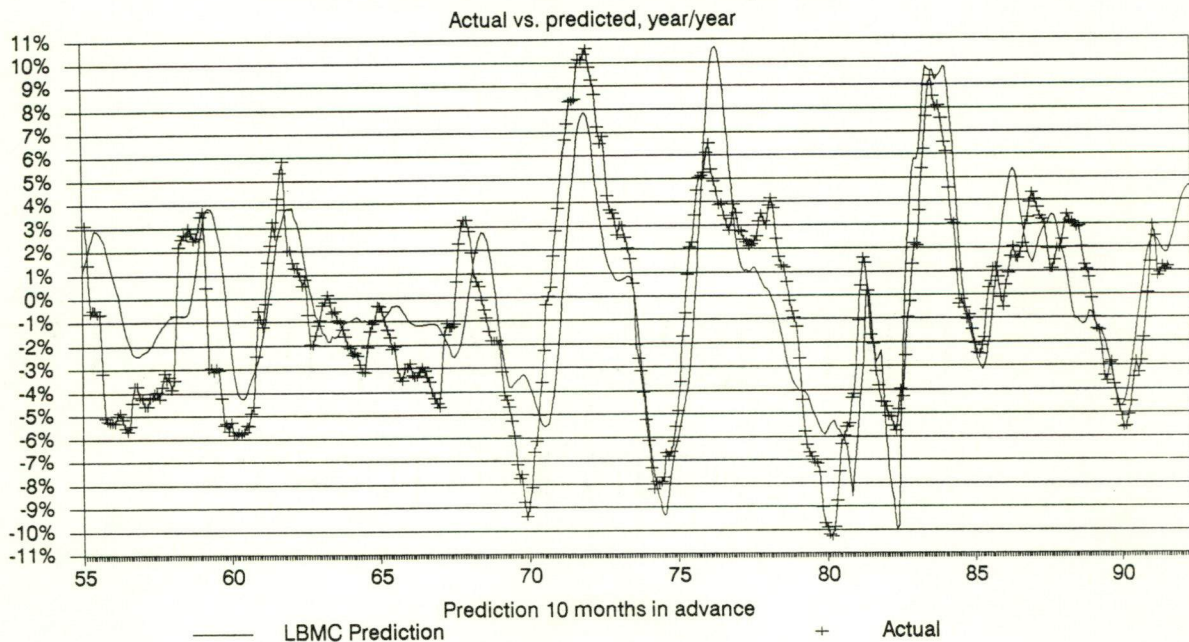


Recently there has been quite widely voiced concern that slow growth of M2 will either prevent economic recovery or cause another recession in 1992. But in recent years the World Dollar Base and

its near-relative, the monetized Federal debt, have given signals quite different from M2. And they suggest, to us at least, that the recent concern over M2 is unfounded. M2 has grown slowly

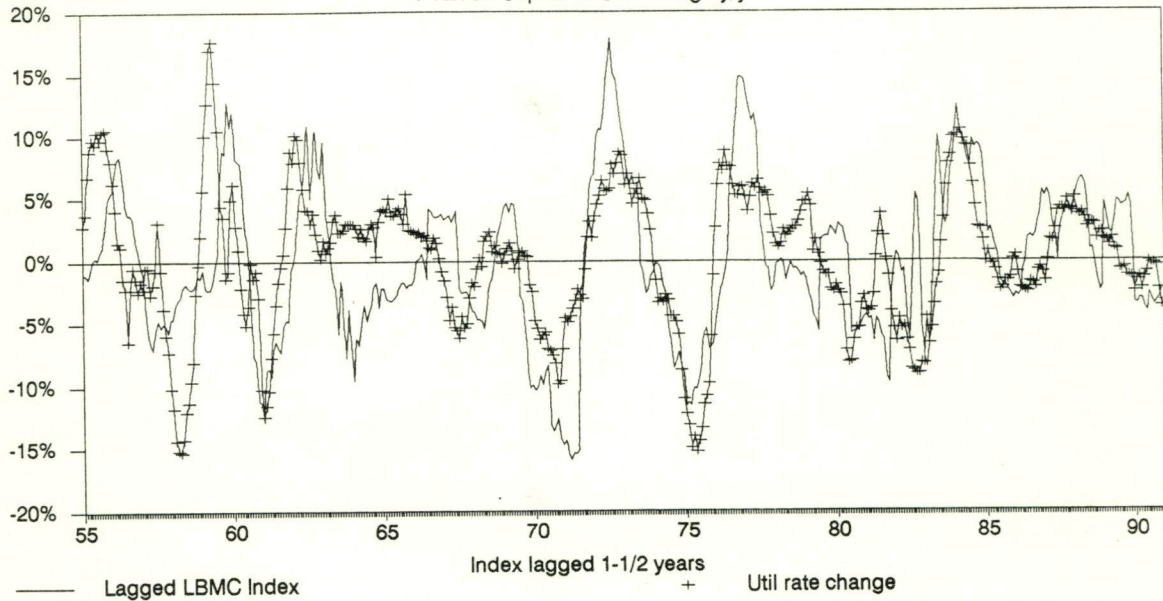
GRAPH 7

Real Monetized Treasury Debt



GRAPH 9 LBMC's Capital Return Index

1-Tax on Capital vs Util. change y/y



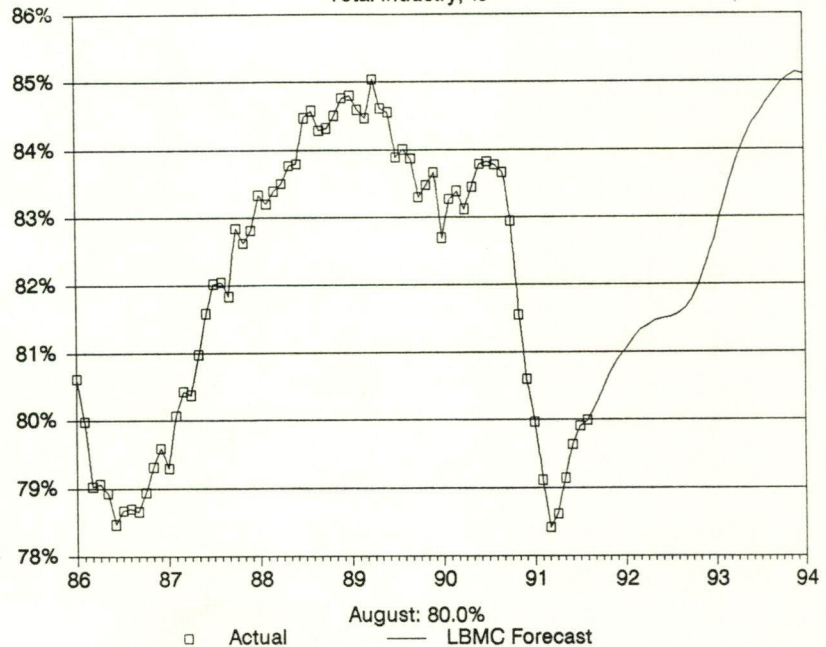
marginal tax rate on capital has still fallen a bit, because those statutory tax increases were more than offset by recent declines of inflation and interest rates. This does not take into account state and local taxes, but recent changes in state and local taxes don't appear large enough to have turned the index negative.

be below average for a postwar recovery. Of course, it's not reasonable to expect a stronger-than-average bounceback after a milder-than-average recession.

What does all this tell us about the course of the current economic recovery? We think it still suggests a recovery stronger than the consensus expects -- a solid 4% real GNP growth rate in the second half of 1991 rather than the consensus 2-1/2%. Our forecast is considered optimistic, but it would

GRAPH 10 Capacity Utilization

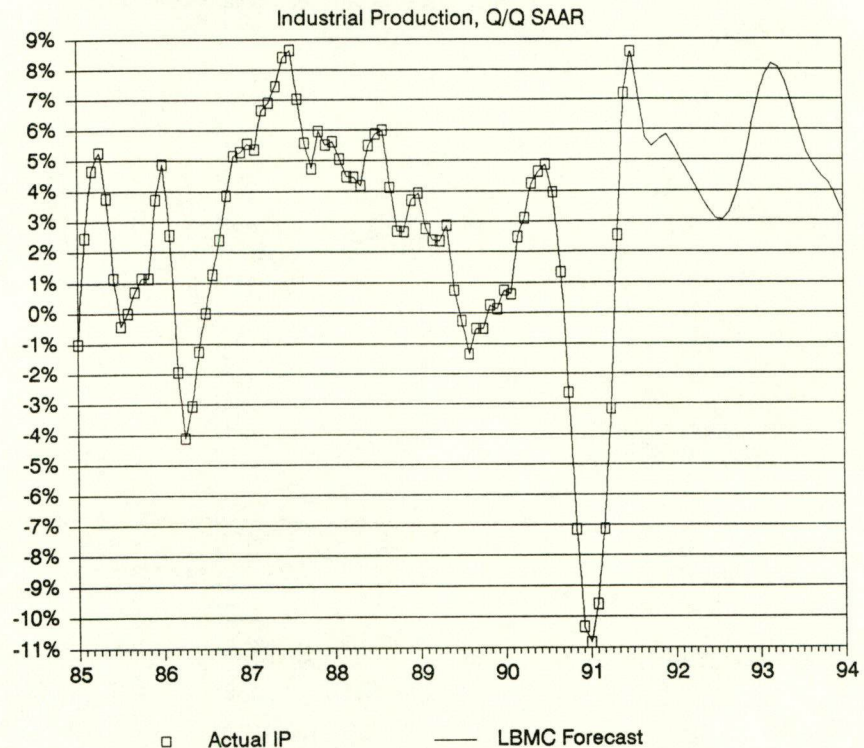
Total industry, %



August: 80.0%
□ Actual — LBMC Forecast

GRAPH 11

LBMC's Growth Forecast



Capacity utilization bottomed out just over 78% in March of 1991 and has climbed to 80%. We think it will rise to a temporary plateau of 81-82% in mid-1992, and then surge to about 85% by the end of 1993 (see Graph 10). This implies that the first surge of growth will be followed first by a temporary slow-down in the middle of 1992, then a second wave of expansion at the end of 1992 and the beginning of 1993

(Graph 11). Not only don't we expect another dip into recession; the odds are that this recovery will last through most if not all of 1994.

We expect CPI inflation to continue to decline, from its 1990 peak of 6.3% to a low of about 3% at the end of 1991 and the start of 1992. The World Dollar Base points to continued disinflation of food and energy commodities for the rest of 1991 and most of 1992. At the same time, "core" inflation should be subdued. Unemployment is coming down, but is still close to 7%. And manufacturing productivity is rising, as it typically does in the early stages of a recovery. As a result, year-to-year CPI inflation should stay in the low-3% range through most of 1992 (Graph 12).

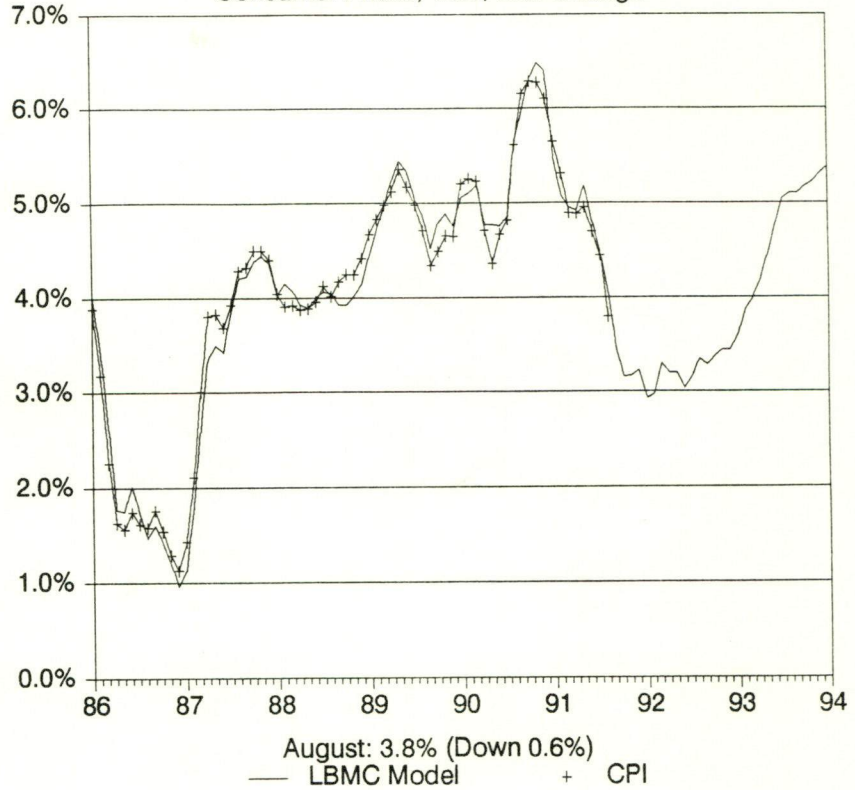
Unfortunately, our analysis suggests that inflation will once again be accelerating by the first half of 1993. The World Dollar Base points to a sharp surge in food and energy commodity prices at the end of 1992 and the first half of 1993. Rising commodity prices and rising capacity use should lead to an acceleration of ex-food-and-energy inflation at around the same time. We therefore expect CPI inflation, after falling to a low of 3%, to rise to a peak of about 5% year-to-year in the middle of 1993.

Typically, such a rise in inflation would induce the Federal Reserve to raise the Federal Funds target, now at 5-1/4%, to 8% or higher in 1993. If so, we can expect inflation-adjusted money growth to slow sharply and effective marginal tax rates to rise even

GRAPH 12

LBMC's CPI Forecast

Consumer Prices, Year/Year Change



without changes in tax law. Depending on the exact timing and size of the response, another mild recession is possible in 1995.

Considering the amount of speculation and uncertainty regarding next month's or next quarter's numbers, this may sound hopelessly long-range. But if past experience is any guide, taking the peculiarities of the dollar standard into account permits us to get the "big picture" broadly right, much further in advance than most people think.

Confidential note,

Bottom line is that he thinks that the candidate (especially if Clinton or Kerry) will not polarize to the left on social values issues, and that they will choose for a theme a moderate "new paradigm" one. [It sounds to me like Dukakis redux, plus some empowerment/social responsibility themes, with average sniping at Bush's conventional shortcomings. In short, something pleasing to the readers of Doonesbury, and a recipe for a Bush sweep.]

Doesn't think abortion will be a leading issue, esp Clinton and Kerry, new paradigm stuff will be, choices available to parents, opportunity to people acting responsibly, workfare -- training and education for two years, then you have to hold a job; college tuition + national service. Certainly not for 'condoms in the schools' stuff. Harkin only likely to try to polarize, doesn't think it'll get him the nomination.

Abortion will become central if Roe is overturned, but not because candidates will make it central. He would advise campaign to support federal legislation setting up a federal right to abortion in order to make Bush veto, which he thinks would hurt him.

Agrees campaign will turn on values because it embodies character. Sees the quasi-consensus on foreign, defense, economic policy (though he sees less of it on economic, and is sure the Republicans will try to portray the Democrats as dangerous extremists, "something they're very good at".) But he doesn't see a polarization on social issues, or the Democratic candidates actively polarizing to the left unless the overthrow of Roe forces the issue. Thinks Bush's "extreme" position on abortion issue will be made something of to make a point on his character, but he doesn't see Clinton or Kerry, or anyone (except maybe Harkin) trying to lead with social values issues as a key salient of their campaign. Notes that Dukakis didn't, Hart didn't until he ran out of money and had to energize the zealots, thinks everyone has sort of learned that that's not a winning strategy.

Thinks -- and I had a hard time following him here -- that the issue in people's minds on abortion is the existence of a right, not the qualifications on the right, and if Roe is overturned, that will be very harmful to Bush (especially if Thomas is the swing vote) because people will see it as a constitutional right which they had has been taken away. He acknowledged my point about the popular support for restrictions, and that Roe's overturn wouldn't ipso facto criminalize abortion, just clean the slate for the states or federal government to decide what the policy ought to be. But he couldn't understand why I couldn't understand that the salient here is the taking away of a right ('of a woman to govern her own body for the first three or six months of a pregnancy'), to which the restrictions are a subsidiary issue. I couldn't understand why he couldn't understand that there's another way to see it, but didn't press it.

#

Economy



Watch

Lehrman Bell Mueller Cannon, Inc.

October 1991

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Jeffrey Bell, President
John Mueller, VP/Economist

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	1991 Second Half	1992 First Half	Comment
Growth	4% real GNP growth in 4th Q.	Growth slows to 2-3% at mid-year.	Growth picks up again late in 1992.
Inflation	CPI 3.5% yr/yr avg., 3.7% annualized.	3.1% yr/yr avg., 2.3% annualized.	3.1% avg. in 1992, 5% peak in 1993.
Interest Rates	30-yr. T-Bond yield just below 8%.	Yield bottoms around 7-1/2%.	Yield hits 8-1/2% in early 1993.
Stocks	Stocks move generally higher.	Rally continues: DJI hits 3,300.	DJI at 3,700 near Election Day 1992.
Dollar	Dollar rises v. DM, stable to down v. yen.	Dollar peaks above DM2.00.	Real bond rates favor U.S.

Stop Us If You've Heard This Before

How soon we forget. "The predicted economic boom never came to pass." "It is clear that nothing of the sort has occurred or will occur." "Today the Administration seems content to sit back and let the deficit eat into the fragile economic recovery." "Now, economic decline threatens." "In order to maintain the slight recovery that we have, we must

make sure that there is enough money in the economy." These statements were made by Members of Congress between June and September of 1983 -- 7 to 10 months *after* the recovery began. As we said in September's **LBMCM Report**, "Not only don't we expect another dip into recession; the odds are that this recovery will last through most if not all of 1994."

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Growth. We've argued that, though below average, this recovery will see two surges of capacity use -- in 1991 and 1993 -- with near-trend growth in between (see graph). After industrial output zoomed at an 8% rate, data for September raised fears that the recovery had stalled. Too soon, we think. We see one more upsurge before the industrial slowdown we've been talking about takes hold (Section 2.5). The initial report of 2.4% real GNP growth in the 3rd quarter was 1 point lower than we predicted, but a rise in lean inventories and steady-to-stronger personal spending should contribute to faster 4th-quarter growth (Section 2.6).

Inflation. We still see CPI inflation falling to a low of about 3% year-to-year at the end of 1991 and staying there for most of the next year. The reasons: continued commodity disinflation and slow growth of labor costs in the initial stages of recovery. But the CPI should bounce back to peak near 5% year-to-year in mid-1993 (Sections 1.4 & 1.5).

Bonds. After rallying strongly, 30-year Treasury bonds have bounced around an 8% yield. We expect them to stay there for a month or two, then rally again on continued low inflation numbers. We look for a 7-1/2% bottom in yields in mid-1992. But we continue to expect the

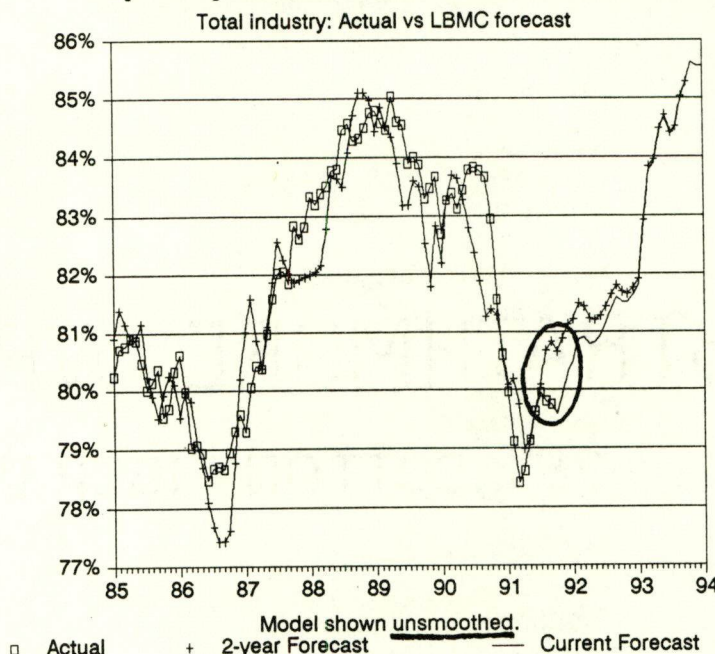
jump in inflation to drive yields up 100 basis points by early 1993 (Sections 3.1 & 3.2).

Stocks. Still bullish on bonds and firmly expecting continued recovery, we've raised our sights slightly on stocks: We expect the Dow Jones Industrials to hit 3,300 by the Spring of 1992. We see a peak on the Dow of about 3,700 by the end of 1992 (Sections 3.3 and 3.4).

Dollar. With inflation falling in the U.S. but stubborn in Germany, real bond yields favor the U.S. We see the greenback rising over DM2. The yen is less sensitive to bond rates, and Japan's international payments are helped by this year's fall in energy prices. So we look for a firmer yen (Section 3.5).

A Blip Down on the Way Up.

Capacity Utilization: 2 Years Ahead



1.0. The Outlook for Inflation

1.1. LBMC's World Dollar Base

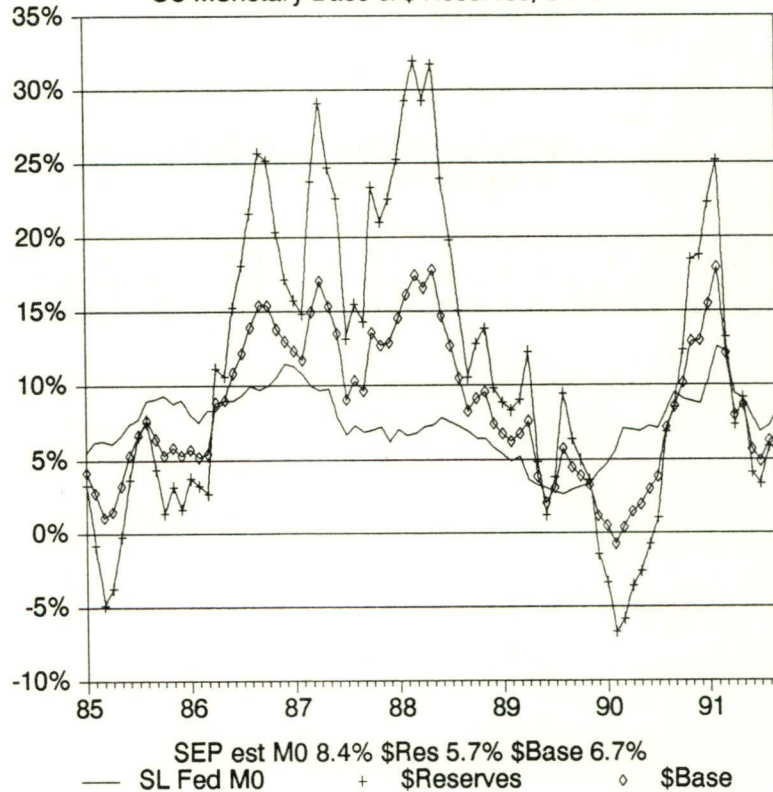
Explanation. The world's central banks and basic commodity markets operate on a "dollar standard." So Lehrman Bell Mueller Cannon, Inc. uses what we call the "World Dollar Base" as a key forecasting tool. In principle, the World Dollar Base comprises the U.S. monetary base ("high-powered money") plus the dollar reserves held by foreign central banks to back their domestic currencies. When the World Dollar Base grows, it adds to liquidity in the dollar market. The first effect is on financial markets, then output; in the longer run, prices (especially raw materials, food and energy prices).

Latest. The 6-month growth rate of the World Dollar Base has settled down in the 7% range after its earlier surge. We expect growth to stay in single digits for the time being. With good inflation news, another round of interest-rate cuts by the Federal Reserve is a strong possibility,

keeping growth of U.S. currency and bank reserves in high single digits. But a firm dollar implies that this won't be matched by foreign central bank purchases of dollar assets. The recent surge and slowdown in the World Dollar Base should contribute to continued economic recovery in coming months, followed by a temporary slowdown of economic growth in the middle of 1992 (see Section 2.1). It also implies a spike of commodity inflation in late 1992 and early 1993 (see graph on next page).

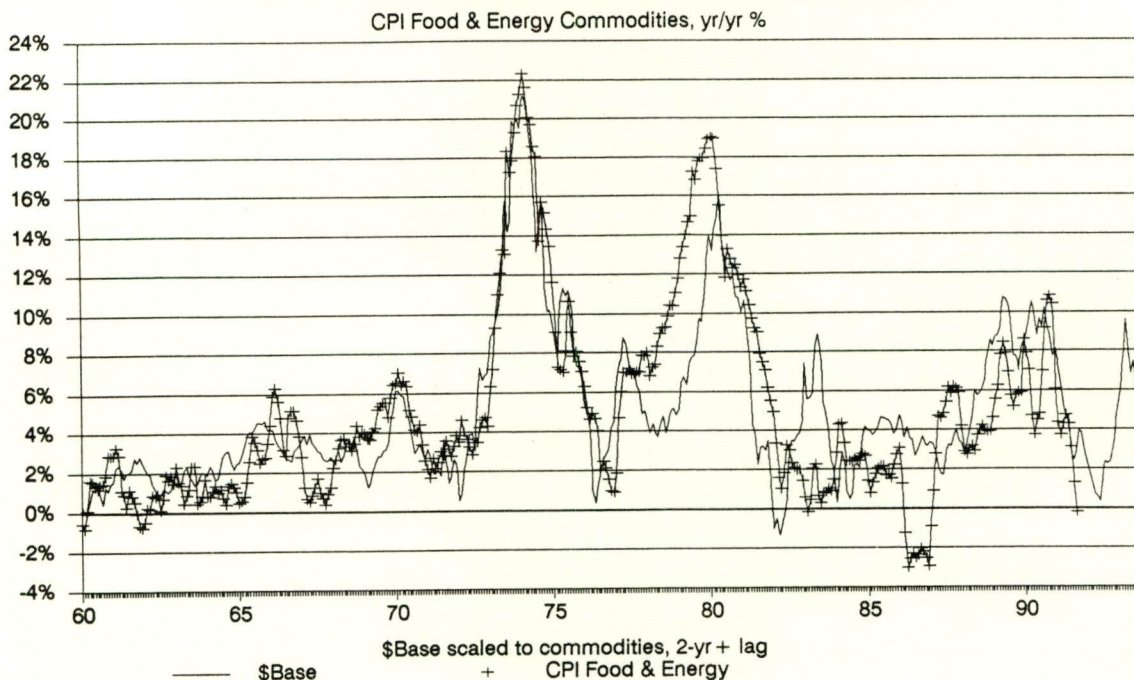
LBMC's World Dollar Base

US Monetary Base & \$ Reserves, 6-mo. AR



Lehrman Bell Mueller Cannon, Inc.

LBMC's World Dollar Base & Commodities



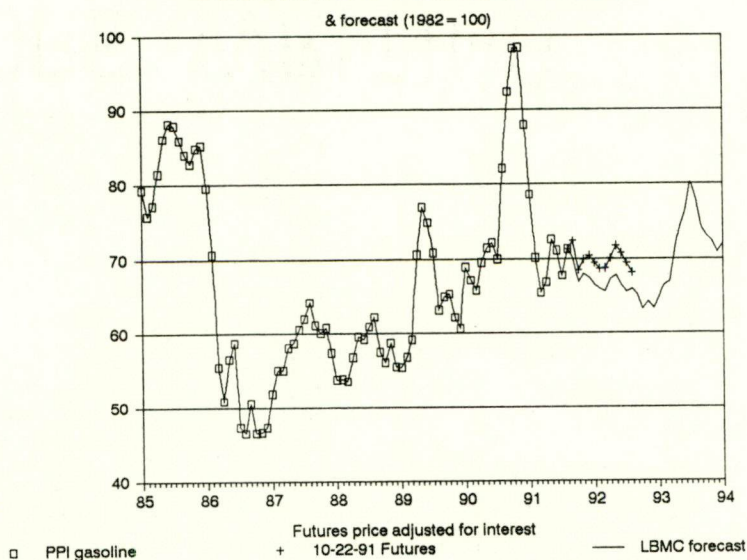
1.2. Commodity Prices

Explanation. The World Dollar Base is useful in predicting overall commodity inflation two years in advance. Of course, specific commodity prices also reflect relative scarcity. For example, due to its importance and semi-cartelized market, energy supply must be analyzed separately. We use the price of gasoline as a benchmark.

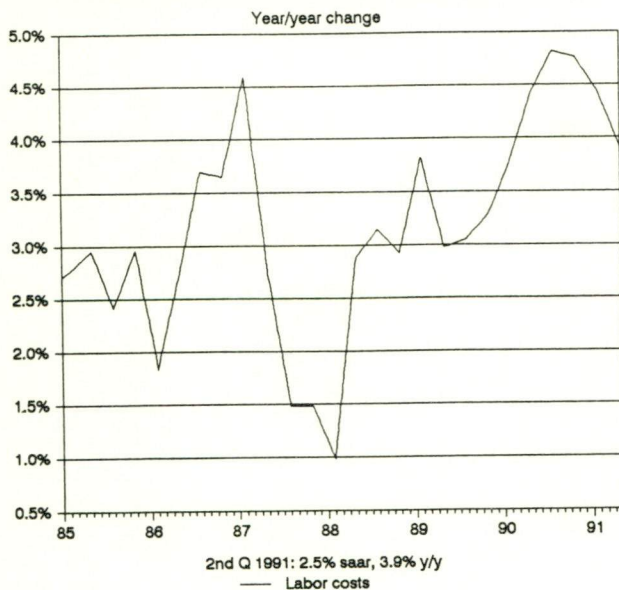
Latest. The energy futures markets have risen since last month, lifting their forecast a bit above one incorporating the World Dollar Base (see graph at right). We expect a

spike in energy prices in the first half of 1993, as recent monetary easing has its maximum impact on energy markets and as supplies tighten.

Gasoline: Producer Price



Nonfarm Unit Labor Costs



1.3. Labor Costs

Explanation. Labor-intensive goods are not priced like commodities. So LBMC's inflation models contain a monthly proxy for wage costs.

Latest. Employment tends to be a lagging indicator of output. That's one reason why labor costs continue to moderate in the early stages of recovery: firms don't rehire workers as fast as demand for their product picks up. This lowers unit labor costs.

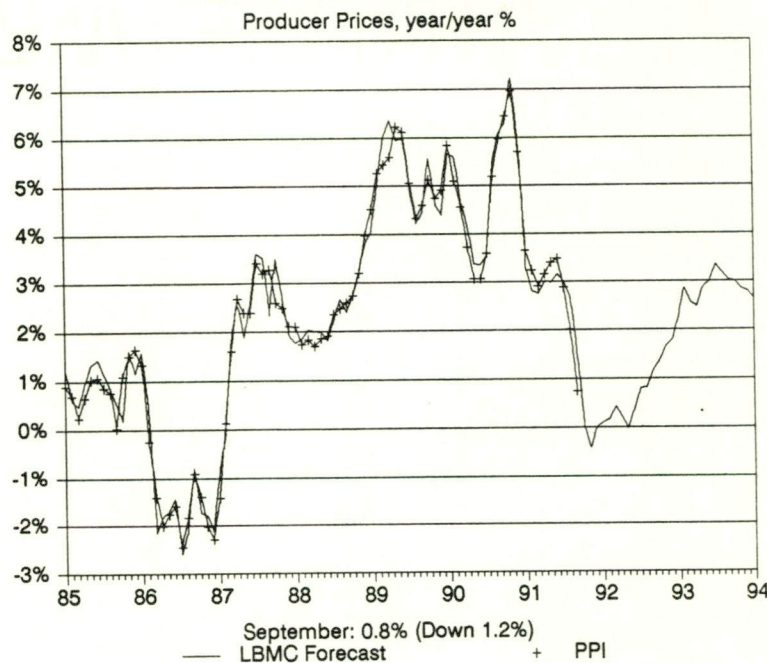
1.4. LBMC's PPI Model

Explanation. LBMC's PPI Model forecasts producer price inflation for finished goods. The model is based on separate forecasts of PPI sub-indexes for food, energy, and other goods.

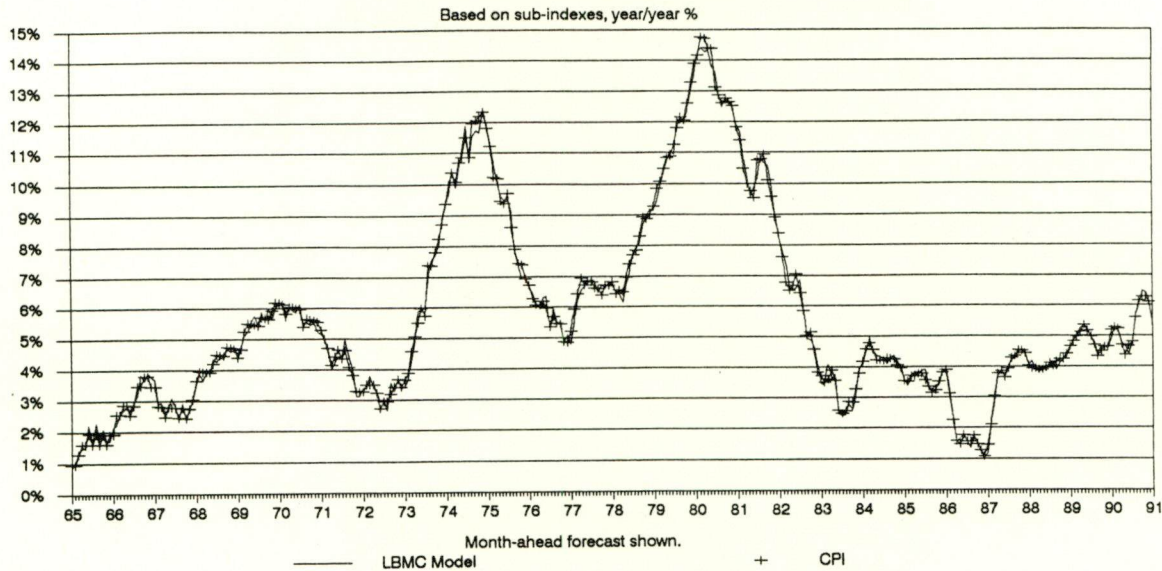
Latest. Producer prices fell 0.3% in September (up 0.1% after seasonal adjustment). As a result, year-to-year PPI inflation fell to 0.8%. Year-to-year PPI inflation should average about 2% in 1991 and 1% in 1992. But we expect PPI inflation to

rise to the 3% range in 1993, as commodity prices rebound (see Sections 1.1 and 1.2) and labor costs pick up again as capacity use rises (see graph on page 2).

LBMC's PPI Forecast



LBMC's CPI Model



1.5. LBMC's CPI Model

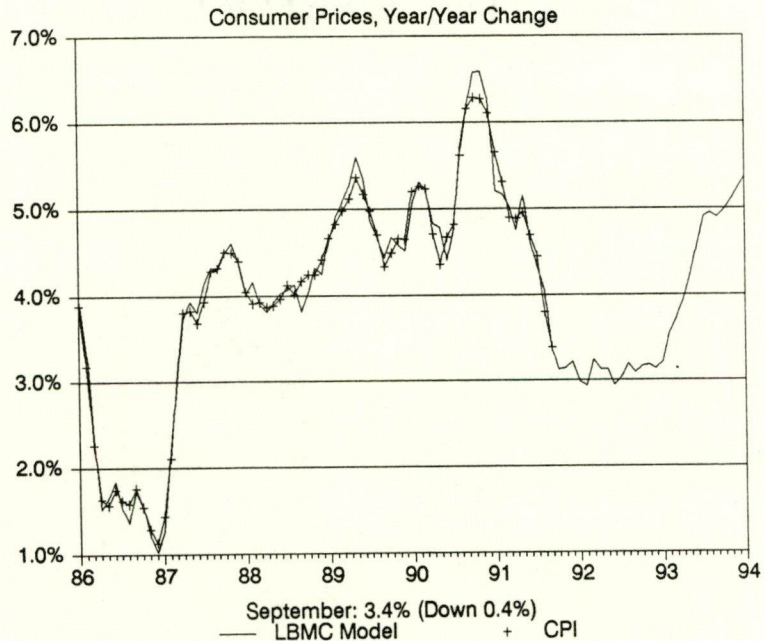
Explanation. Like our PPI Model, LBMC's CPI Model is based on separate explicit forecasts for the food, energy, and ex-food-and-energy sub-indexes.

Latest. The CPI rose 0.4% in September (also 0.4% after seasonal adjustment). This cut year-on-year inflation to 3.4%.

A 0.4% rise in "core" inflation raised fears that improvement had stalled. But we look for improvement in October's numbers, and an overall CPI rise of only 0.2%. We still expect year-to-year CPI inflation to fall to a low of

about 3%. CPI inflation should average 4.3% year-to-year in 1991 and 3.1% in 1992. But we expect the CPI to rise to a peak of about 5% year-to-year in mid-1993.

LBMC's CPI Forecast



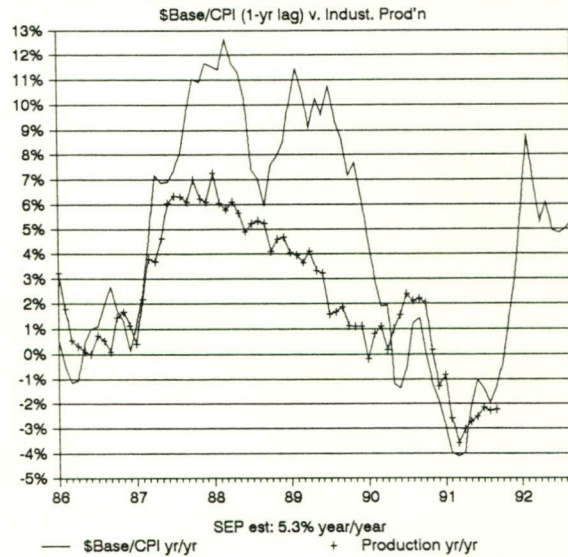
2.0 The Outlook for Growth

2.1 "Real" World Dollar Base

Explanation. The *level* of output is mostly determined by supply factors; but business-cycle *fluctuations* are partly related to "excess" money -- money not demanded to exchange wealth at existing prices (see "The Rueffian Synthesis" and "The World Dollar Base and Business-Cycle Forecasting," June/July & September 1991 LBM Reports). A good measure of "excess" money is Treasury debt monetized by the banking system (graph below). In recent years, increases in the World Dollar Base have formed the bulk of such monetization.

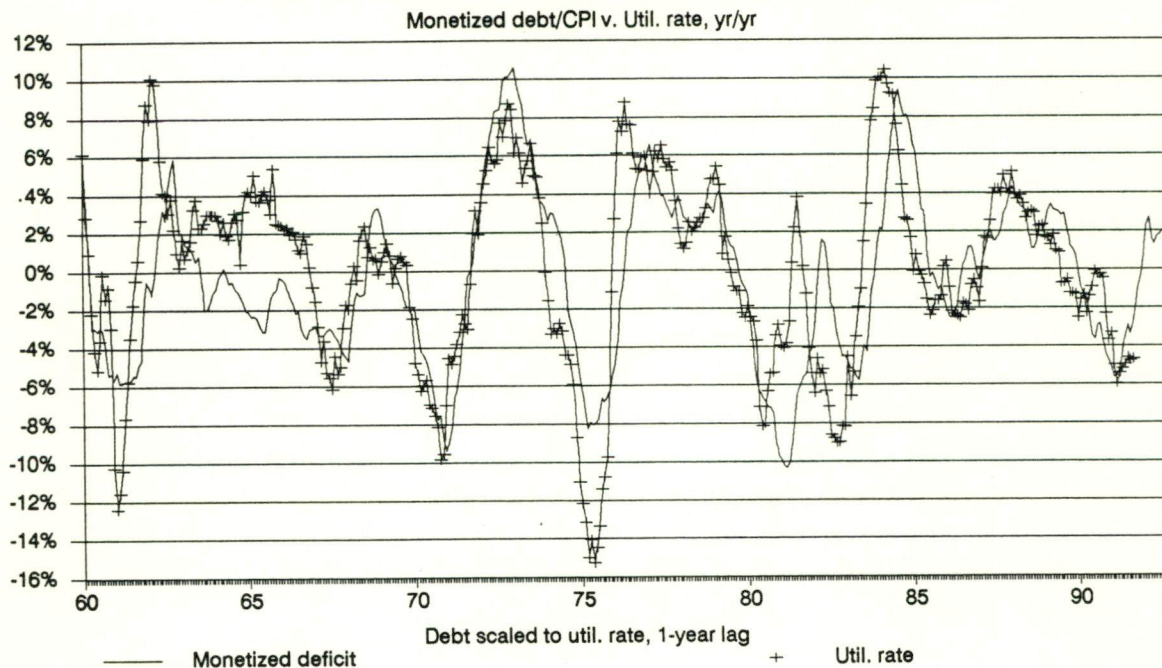
Latest. After inflation, LBM's World Dollar Base grew 5.3% year-to-year in

LBM's World Dollar Base & Output



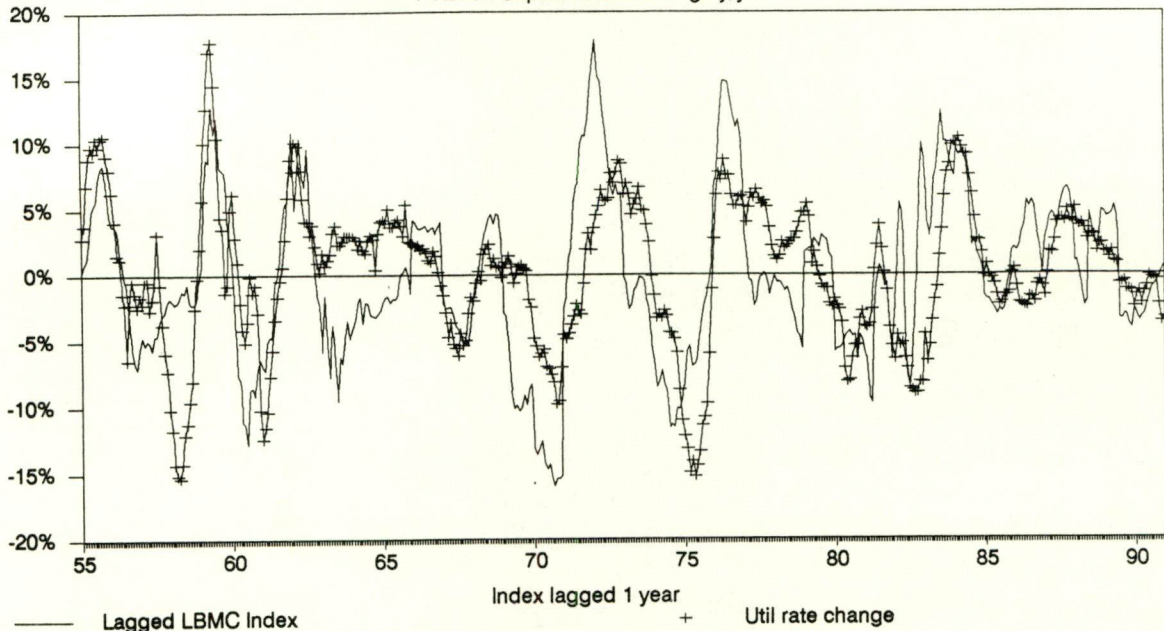
September. Though moderating after the earlier surge, this growth cannot be described as "tight."

Monetized Federal Debt & Capacity Use



LBMC's Capital Return Index

1-Tax on Capital vs Util. change y/y



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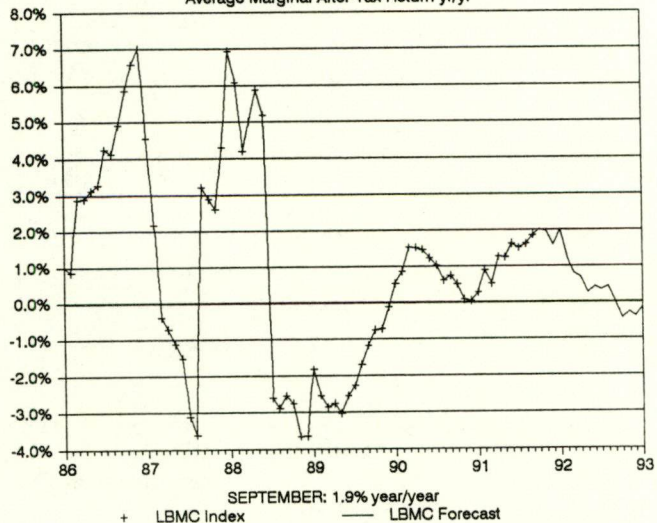
2.2.LBMC Capital Return Index

Explanation. The LBMC Capital Return Index is a monthly indicator of the supply-side effect of Federal tax policy on the return to capital. The index includes Federal taxes on corporate income, personal income, and capital gains. When the marginal tax on capital falls, the index rises. Even without changes in tax law, the tax rate changes each month with the expected inflation rate (since capital gains are not indexed for inflation), and with interest rates (which alter the value of tax deductions for depreciation). Thus monetary policy and effective marginal tax rates are related.

Latest. LBMC's Capital Return Index rose slightly in September -- up almost 2% year-to-year, mostly due to the positive effects of falling inflation and lower interest rates.

LBMC Capital Return Index

Average Marginal After-Tax Return yr/yr



SEPTEMBER: 1.9% year/year
+ LBMC Index — LBMC Forecast

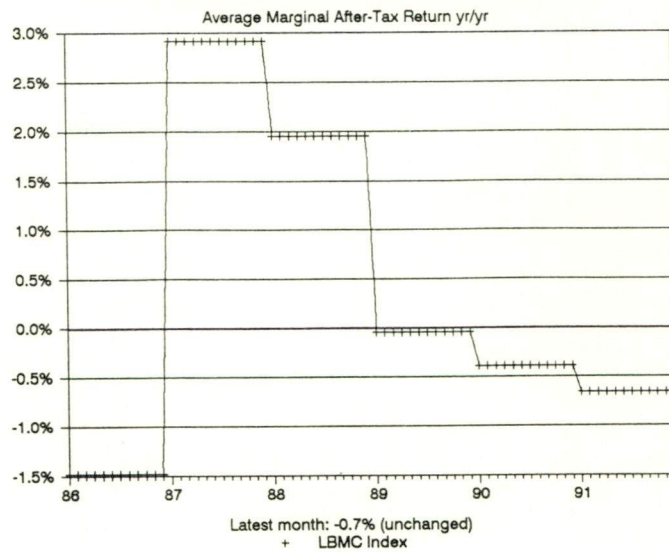
Lehrman Bell Mueller Cannon, Inc.

2.3. LBMC Labor Return Index

Explanation. The LBMC Labor Return Index charts the change in the marginal return to labor after Federal income and payroll taxes.

Latest. The supply-side effect on labor of Federal tax policy remains slightly negative in 1991, largely due to a rise in the top income and Medicare tax rates on January 1.

LBMC Labor Return Index



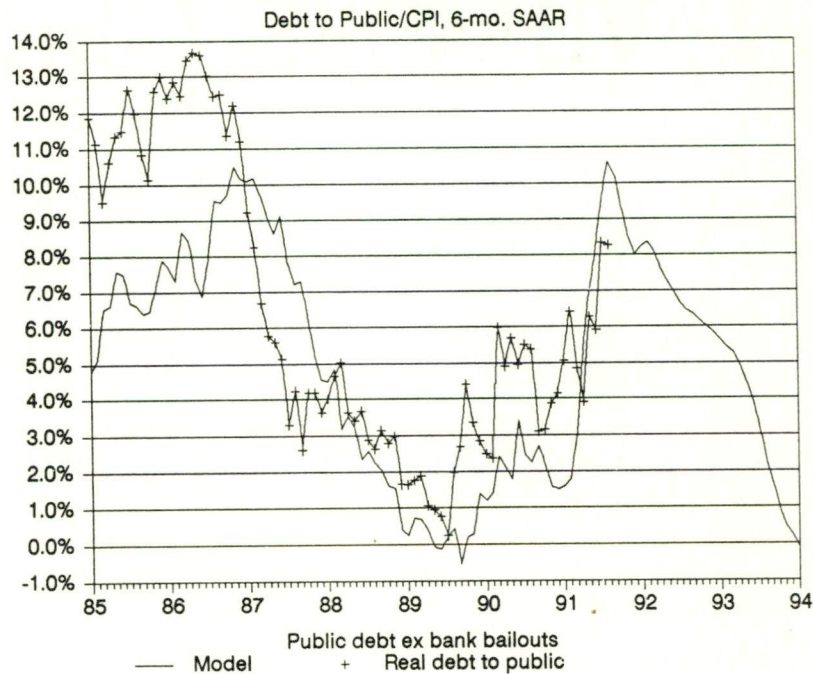
2.4. "Real" Federal Debt

Explanation. We've come to the view that Federal deficits have no major impact on growth unless they are monetized (see Section 2.1). But they can affect the composition of output. Under floating exchange rates, a non-monetized deficit can attract foreign capital, causing the dollar to appreciate. Additional domestic consumption or investment financed by the deficit tends to be offset by a decline in net exports.

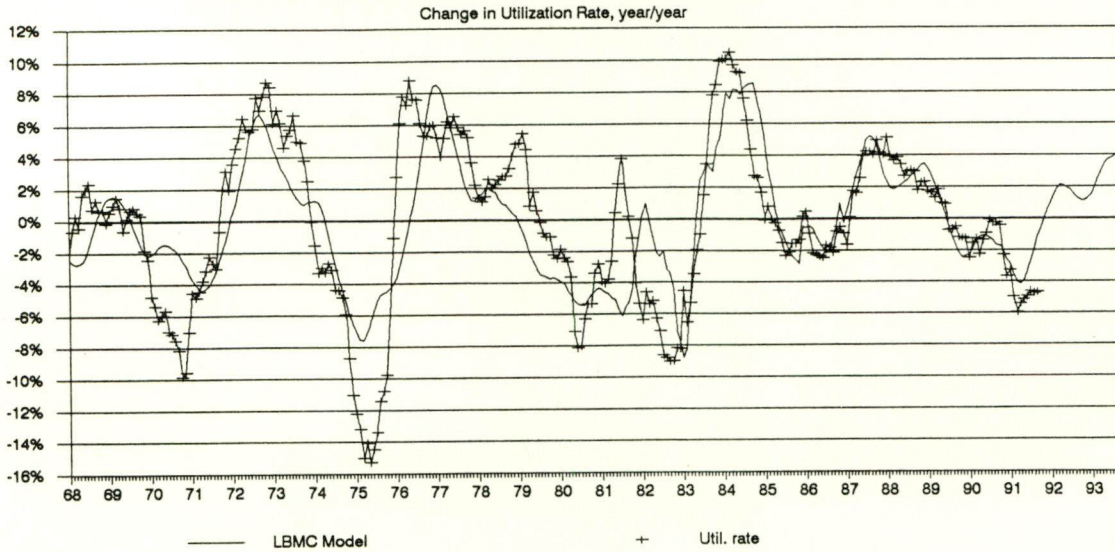
Latest. As we argued last month, "We

expect inflation-adjusted growth of debt to the public to peak in coming months... as the recovery proceeds." A declining percentage of a large debt will still mean a large deficit, however.

LBMC's Federal Debt Model



LBMC Growth Model: Almost 2 Years Ahead



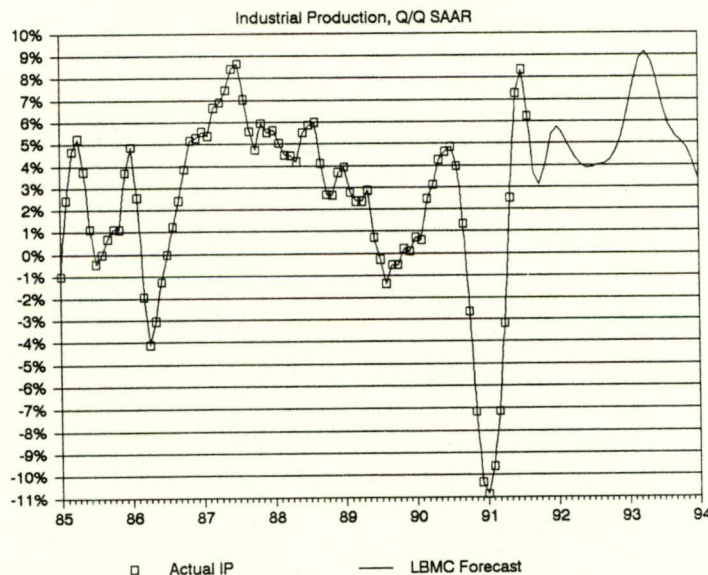
2.5. The LBMC Growth Model

Explanation. LBMC's Growth Model begins with a forecast of the rate of change in capacity utilization, based on the LBMC indexes for government monetary and fiscal policies. This is combined with a forecast of industrial capacity to produce a forecast of industrial production.

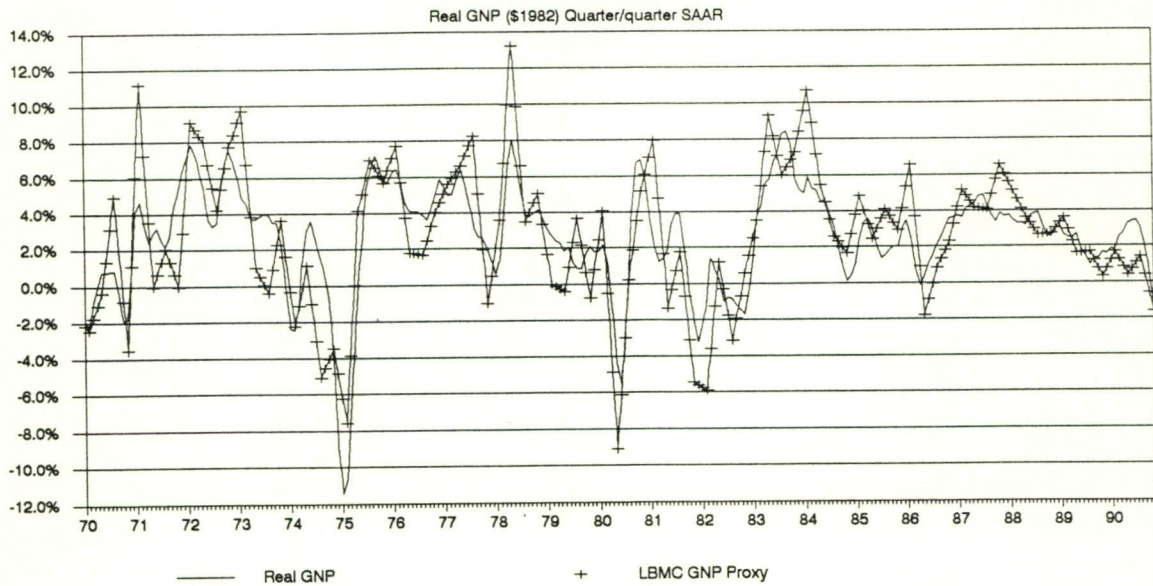
Latest. Industrial production rose 0.1% in September, and August was revised down. However, manufacturing, which accounts for 90% of the index, rose 0.5%, but was offset by a large fall in utilities. The quarterly growth rate for the third quarter registered 6.2% (we forecast 6% back in February).

We expect quarterly growth rates in industrial production to register 3-4% in the 4th quarter and 5-6% in the 1st quarter of 1992. The quarterly rate should slow in mid-1992, before rebounding at the start of 1993. We anticipate that the economic expansion will last into if not through 1994.

LBMC's Growth Forecast



LBMC's GNP Proxy



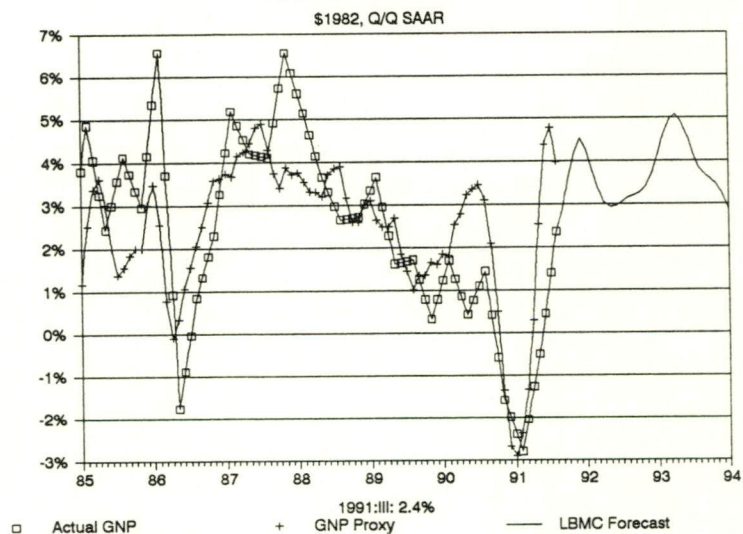
2.6. LBMC's GNP Proxy

Explanation. LBMC's Monthly GNP Proxy is based on industrial production. While the output of goods is only about two-fifths of GNP, on average it accounts for more than four-fifths of changes in real GNP over 6-month periods -- and more than 2/3 of the quarterly real GNP growth rate (graph above).

Latest. The government's initial estimate of 3rd-quarter real GNP growth was 2.4% -- close to the consensus, and about 1 point less than we predicted. Lower inventories continued to subtract from GNP, though not as much as the previous quarter. We expect quarterly real GNP

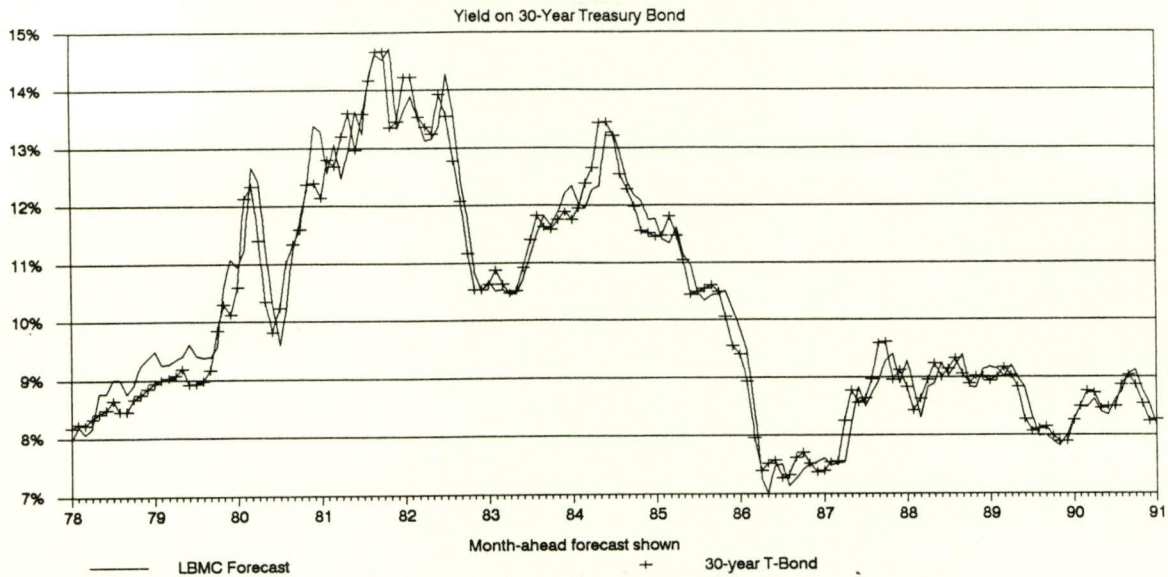
growth to peak close to 4% before slowing in mid-1992. Real GNP should rise about 0.9% 4th-Q-over-4th-Q in 1991, and 3.3% in 1992. However, planned 5-year revisions to GNP accounts -- and a switch to emphasis on GDP (Gross Domestic Product) will probably change the numbers significantly.

Real GNP Growth



3.0. The Outlook For Financial Markets

LBMC's Treasury Bond Model



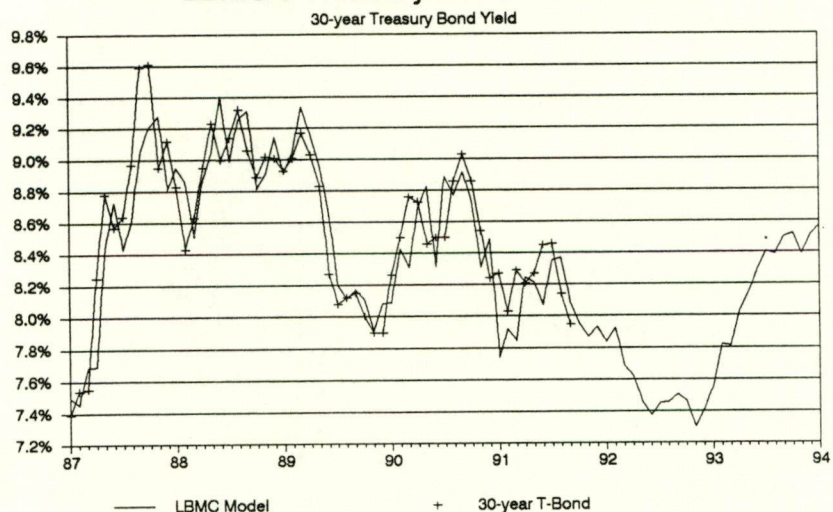
3.1. LBMC Treasury Bond Model

Explanation. LBMC's Treasury Bond Model is designed to forecast the monthly average yield of the 30-year Treasury Bond. The forecast is based on LBMC's forecasts of the economy, central bank policy and investor expectations about inflation and the dollar.

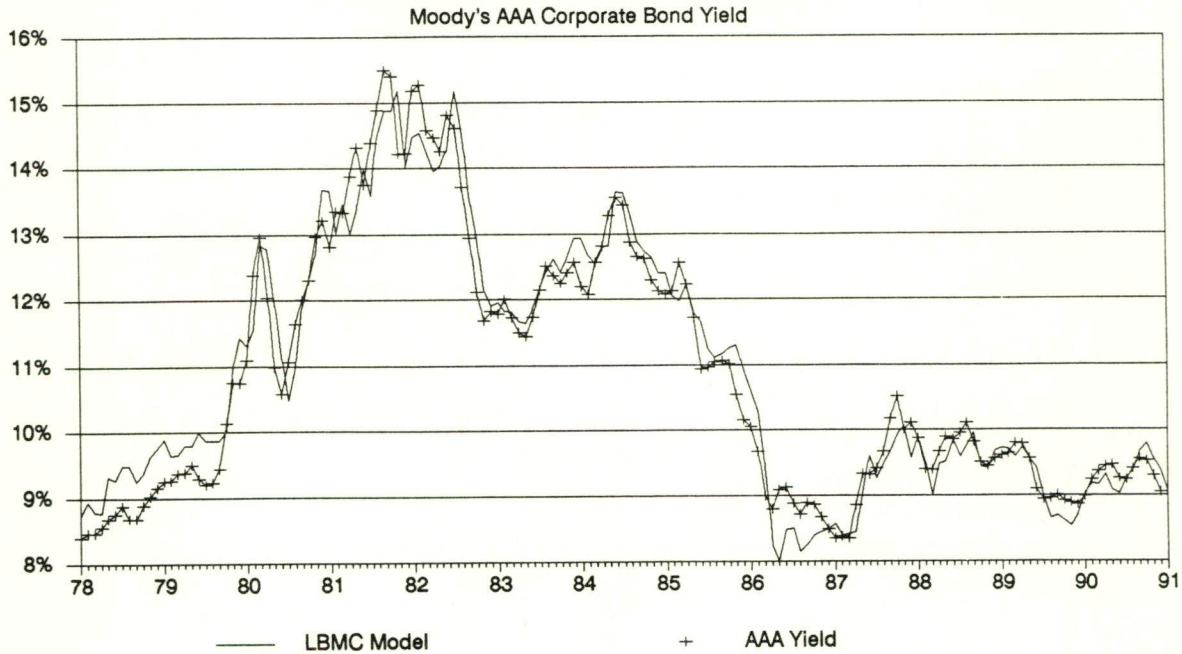
Latest. The 30-year T-Bond yield bounced around 8% in October. We ex-

pect the yield to say there several weeks, then dip below 7-1/2% in mid-1992 on low inflation and temporarily slowing recovery. The yield should average just under 8% in the remainder of 1991 and about 7.6% in 1992. But we see yields rising with inflation in early 1993.

LBMC's Treasury Bond Forecast



LBMC's Corporate Bond Model



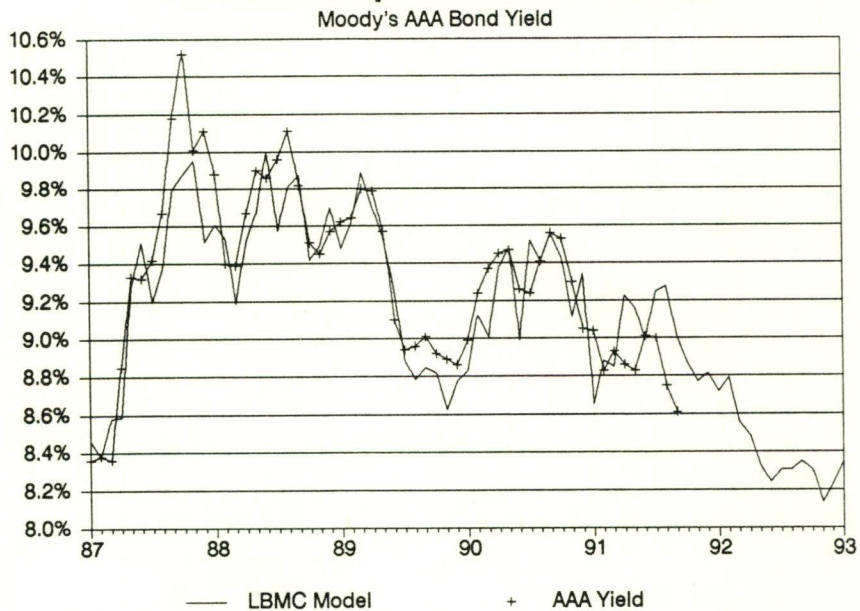
3.2. LBMC Corporate Bond Model

Bond Model sees the AAA corporate bond yield averaging 8.9% in 1991 and 8.4% in 1992.

Explanation. The LBMC Corporate Bond Model is designed to forecast the medium-term trend in the yield of Moody's AAA Corporate Bond index. The AAA yield forecast is based on a varying markup over our forecast for the Treasury bond yield.

Latest. The LBMC Corporate

LBMC's Corporate Bond Model



3.3. The LBMC Liquidity Index as a Long-Term Stock Guide

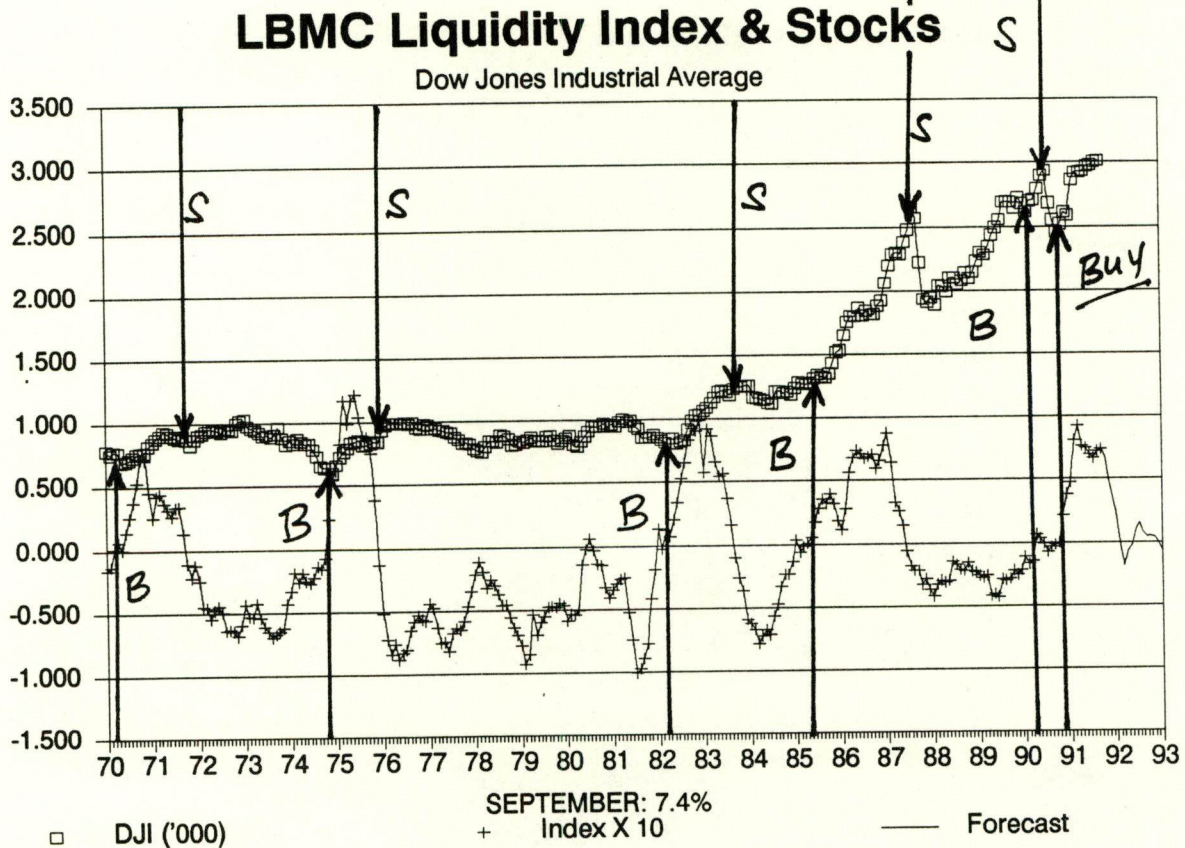
Explanation. The LBMC Liquidity Index is a monthly indicator of liquidity growth in the U.S. economy. The banking system, led by the Fed, supplies liquidity, while growth or inflation "absorbs" liquidity.

The LBMC Liquidity Index serves as a useful guide for strategic stock investment. When the Liquidity Index turns positive, it acts as a major "buy" signal for stocks; when the Liquidity Index turns negative, it acts as a major "sell" signal.

The LBMC Liquidity Index gives relatively few buy and sell signals. But in the past using this method has made possible higher returns than buy-and-hold. For the chart below, buy-and-hold would have yielded 284% in capital gains (ignoring dividends and foregone interest), but following the Liquidity Index would have yielded 519%.

Between signals, the Long-Term Index is not intended as a guide for short-term investments. For our near-term outlook, see the following section.

Latest. LBMC's Long-Term Liquidity Index shows liquidity still rising rapidly, signaling a long-term "buy."



3.4. LBMC Liquidity Index as a Medium-Term Stock Guide

Explanation. The Liquidity Index used in Section 3.3 as a long-term bull/bear market indicator can also be used to gain important information about shorter-term stock market moves.

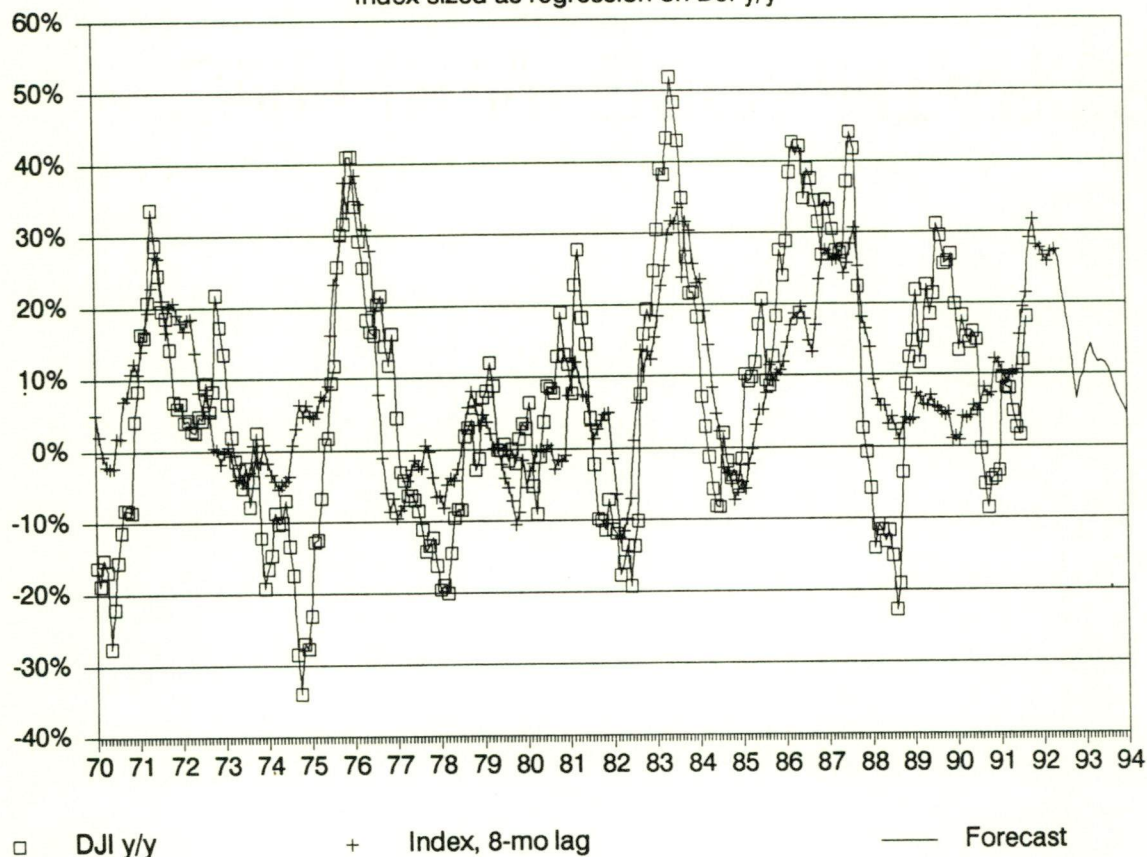
In this section the LBMC Liquidity Index is rescaled for comparison with the year-on-year increase in the Dow Jones Industrials. The LBMC Liquidity Index leads the stock market by about six

to eight months. Being based purely on liquidity, the index does not directly include such influences on the stock market as valuation, taxation, leverage, exchange rates or investor expectations.

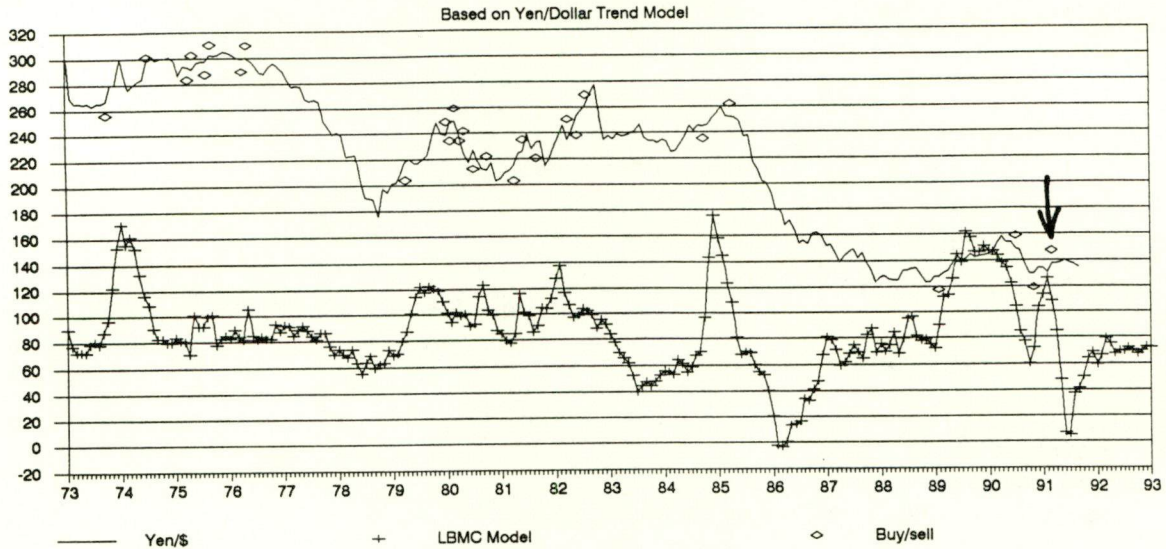
Latest. The lagged effect of liquidity is positive (see graph), and with a somewhat larger bond rally in prospect, we've raised our view of stock performance over the next year. We see the Dow Jones Industrials hitting 3,300 in the first half of 1992. And we expect the Dow to reach a peak of about 3,700 by the end of 1992.

LBMC Liquidity Index & Change in Stocks

Index sized as regression on DJI y/y



LBMC's Yen/Dollar Signal

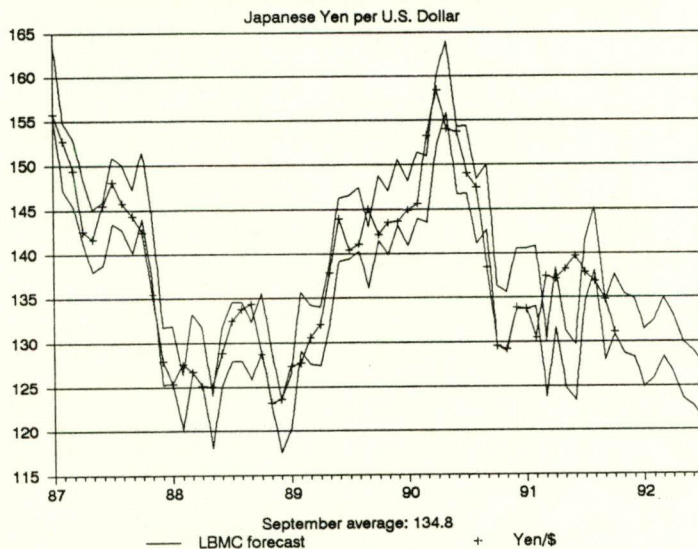


Section 3.5. LBMC's Yen/Dollar Forecast

Explanation. LBMC's Yen-Dollar Trend Model is designed to help determine turning points in the yen/dollar exchange rate. The basic factors in the forecast are central bank policy and the terms of trade. The top graph shows how the model can be used as a buy/sell signal. A buy (or sell) is indicated when the model's rate of change turns positive (or negative); the zero line is shown here as 100. The graph below translates the economic fundamentals of the model into a forecast for the actual yen/dollar rate, taking into account the "bandwagon effect" of trend-followers. The forecast "band" reflects the confidence limits of a 1-month-ahead forecast.

Latest. We continue to expect a recovery of the dollar against the European currencies, as real bond rates move to favor the U.S. But the dollar remains a long-term "sell" against the yen, though we expect a brief bounce upward before the dollar renews its decline. Main reasons: continued Fed easing and this year's fall in oil prices.

LBMC's Yen/Dollar Trend Forecast





Survey of State Tax Rates and Collections

Rates for FY'92 Rise Sharply; Collections for FY'90 Break \$300 Billion

by Gregory S. Leong

Economics Taxes General

Thirty states have enacted tax increases that will raise a total of \$17 billion in new revenue in FY1992, making FY'91 the biggest revenue-raising year in history at the state level. In addition to hiking tax rates, states increased taxes indirectly by broadening taxable bases, extending temporary hikes, and conforming to federal tax rates. They also enacted a host of "non-tax" revenue-raising measures, such as higher fees and accelerated collections, that will bring in approximately \$2.4 billion more in FY'92 revenue.

Gasoline and tobacco were the most popular targets as 23 states hiked the amounts they collect at the pump and 14 states raised

their cigarette excises. The bulk of the new revenue will not come from higher excise rates, however, but rather from higher sales taxes in six states, and higher personal income taxes in eight states.

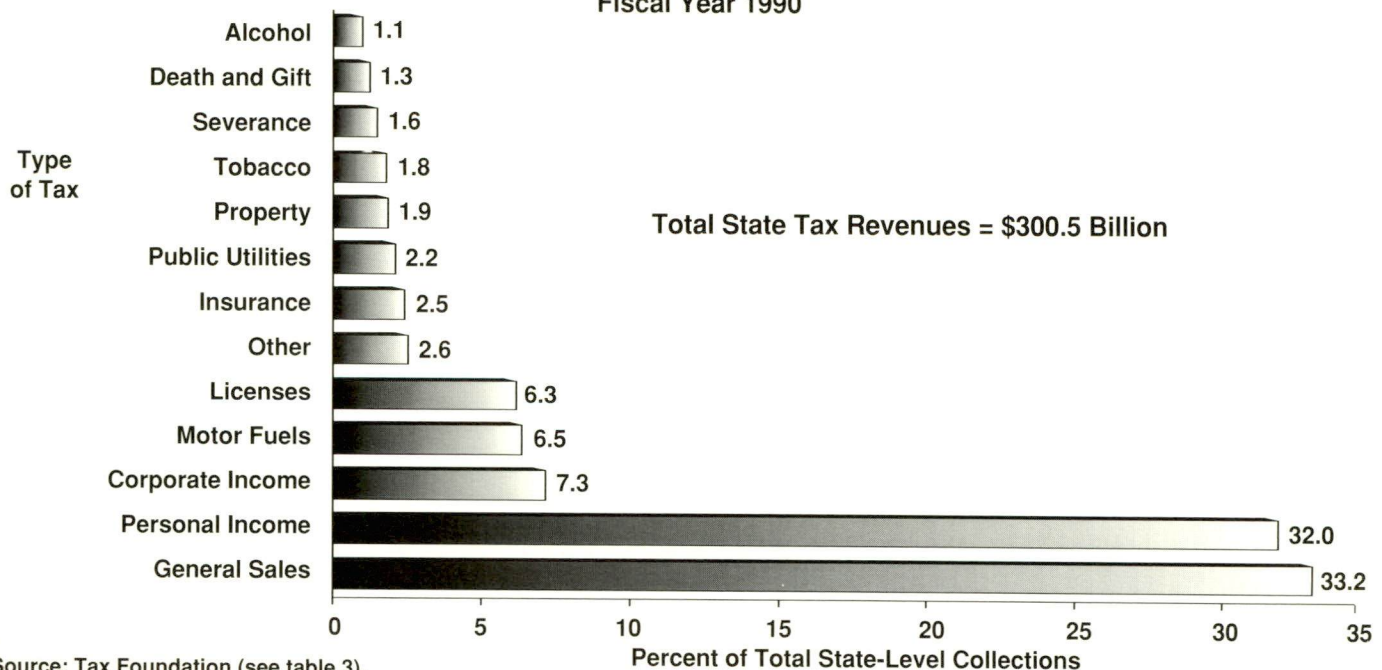
Individual Income Taxes

Connecticut was the only state to enact a new broad-based income tax this year. Lawmakers there repealed taxes on capital gains, dividends, and interest income, replacing them with a flat 4.5 percent income tax. All told, the state's FY'91 tax package is expected to net \$1 billion in new FY'92 revenues. With this new tax system, Connecticut joins six

Figure 1

Percentage Distribution of State Government Tax Collections by Source

Fiscal Year 1990



Gregory Leong is Director of Special Studies at the Tax Foundation.

Table 1
Major State Taxes and Rates
as of August 1, 1991

State	Corporate	Individual	General Sales and Use Tax	Gasoline Tax (per gallon)	Cigarette Tax (per pack of 20)	Property Tax
Alabama	5% (F)	2 to 5% (F)	4% (a)	11 cents	16.5 cents	X
Alaska	1 to 9.4	none	none	8	29	X
Arizona	9.3	3.8 to 7	5 (a)	18	18	X
Arkansas	1 to 6.5	1 to 7	4.5 (a)	18.5	22	X
California	9.3 (c)	1 to 11 (c)	6 (a,d)	15 (b)	35	X
Colorado	5 to 5.2 (d)	5 (c)	3 (a)	22	20	X
Connecticut	11.5 (f)	4.5 (g)	8 (d)	23 (b)	40 (b)	X
Delaware	8.7 (w)	3.2 to 7.7	none	19 (l)	24	
District of Columbia	10 (f)	6 to 9.5 (f)	6	18	30	X
Florida	5.5 (c)	none	6 (a)	4 (w)	33.9	X
Georgia	6% of taxable net income	1 to 6	4 (a)	7.5 + 3% of retail	12	X
Hawaii	4.4 to 6.4	2 to 10	4 (a)	24.8 to 32.5 (v)	40% of wholesale	
Idaho	8	2 to 8.2	5	22 (v)	18	X
Illinois	4.8 (h)	3 (h)	6.25 (a)	19 (d,w)	30	X
Indiana	3.4 (i)	3.4	5	15	15.5	X
Iowa	6 to 12 (F,j)	.4 to 9.98 (c,F)	4 (a)	20	36	
Kansas	4.5 (f)	3.65 to 5.15 (k)	4.25 (a)	17 (b)	24	X
Kentucky	4 to 8.25	2 to 6	6 (a)	15 (e)	3	X
Louisiana	4 to 8 (F)	2 to 6 (F)	4 (a)	20	20	X
Maine	3.5 to 8.93	2 to 8.5 (o)	6 (d)	19	37	X
Maryland	7	2 to 5	5	18.5	16	X
Massachusetts	9.5 (e,m)	6.25 (n)	5	21 (e)	26	X
Michigan	2.35	4.6	4	15	25	X
Minnesota	9.8 (c)	6 to 8.5	6.5 (a,d)	20.25	43	X
Mississippi	3 to 5	3 to 5	6	18 (d)	18	X
Missouri	5 to 6.5 (d,F)	1.5 to 6 (F)	4.225 (a,d)	11	13	X
Montana	6.75 (f,s)	2 to 11 (F)	none	20	18	X
Nebraska	5.58 to 7.81	2.37 to 6.92	5 (a)	23.71 (v)	27	X
Nevada	none	none	5.75 (a,b)	18	35	X
New Hampshire	8	5 (g)	none	18	25	X
New Jersey	9 (f,t)	2 to 7	7	10.5	40	X
New Mexico	4.8 to 7.6	1.8 to 8.5	5	16.2	15	X
New York	9 (c,d,e,f,u)	4 to 7.875 (d,p)	4 (a)	8	39	
North Carolina	7.75 (f)	6 to 7.75	4 (a)	22.6 (v)	5	X
North Dakota	3 to 10.5 (c,F)	2.67 to 12 (F,q)	5	17 (d)	29	X
Ohio	5.1 to 8.9	.743 to 6.9	5 (a)	21 (v)	18	X
Oklahoma	6	.5 to 7 (k,F)	4.5 (a)	16 (e)	23	
Oregon	6.6	5 to 9 (F)	none	20	28	X
Pennsylvania	12.25	3.1 (d)	6 (a)	12	31	X
Rhode Island	9 (f)	27.5 % of modified Federal Income tax	7	26 (e)	37	X
South Carolina	5	2.5 to 7	5 (a)	16	7	X
South Dakota	none	none	4 (a)	18	23	
Tennessee	6 (g)	6 (g)	5.5 (a)	21 (w)	13	
Texas	none	none	6.25 (a)	20	41	
Utah	5	2.55 to 7.2 (F)	5 (a)	19 (w)	26.5	X
Vermont	5.5 to 8.25	28% of federal income tax liability (d,o)	5	15	18 (b)	X
Virginia	6	2 to 5.75	3.5 (a)	17.5	2.5	X
Washington	none	none	6.5 (a)	23 (l)	34 (d)	X
West Virginia	9.15	3 to 6.5 (c)	6	15.5	17	X
Wisconsin	7.9	4.9 to 6.93	5 (a)	22.5 (l)	30 (e)	X
Wyoming	none	none	3 (a)	9 (l)	12	X

(X) Indicates property tax levied.
(F) Allows federal income tax as a deduction.
(a) Local taxes are additional.
(b) Future increases scheduled under current law. As of October 1, 1991. CT gas tax -25 cents, and cigarette tax -45 cents.
(c) Alternative minimum tax is imposed.
(d) Future reductions scheduled under current law. CT sales tax drops to 6% October 1,1991.
(e) Alternative methods of calculation may be required.
(f) Corporate surtax is imposed, CT - 20%, DC - 5%, KS - 2.25%, NJ - .375%, NY - 15%, NC - 4%, ME - 10%, MT - 5%, RI - 11%. CT surtax scheduled to decrease to 10% in 1992 and be eliminated in 1993.
(g) In NH and TN, rates apply to income from dividends and interest. In CT, lower rates applied to income from interest and dividends. Additional changes in deductions also added in 1991 for CT.
(h) Additional 1.5-2.5% personal property replacement tax imposed.
(i) A supplemental net income tax is imposed at 4.5%.
(j) Franchise tax is 5% of taxable net income.
(k) In KS and OK, higher rates may apply to taxpayers deducting federal income tax.
(l) Tax rate is periodically adjusted administratively.
(m) Excise tax is imposed equal to the greater of (a) \$2.60 (includes surtax) per \$1,000 of value of MA tangible property not taxed locally or net worth allocated to MA, plus 9.5% (includes surtax) of net income, or (b) \$400.
(n) Tax of 12% on income derived from interest, dividends, and capital gains.
(o) Income surtax imposed, ME - 5-15%, VT - 3-6%.
(p) Qualified taxpayers may elect to pay alternative taxes at varying rates.
(q) Election to be taxed on 14% of taxpayer's federal income tax liability.
(r) Additional county transportation tax levied.
(s) 7% rate for corporations using "water's edge" apportionment.
(t) A 7.25 % corporation income tax is imposed on entire net income of foreign corporations not subject to the corporation business tax.
(u) Small business taxpayers are subject to a lower rate.
(v) Includes additional taxes or fees. Hawaii gas rates include county rates.
(w) Additional tax or surcharge imposed.
Sources: Compiled by Tax Foundation from survey of state revenue offices and data reported by Commerce Clearing House through July 1, 1991.

income taxes, insurance taxes, and sales taxes grew the fastest, jumping 159 percent, 138 percent, and 131 percent respectively.

FY'90 Collections Reach All-Time High

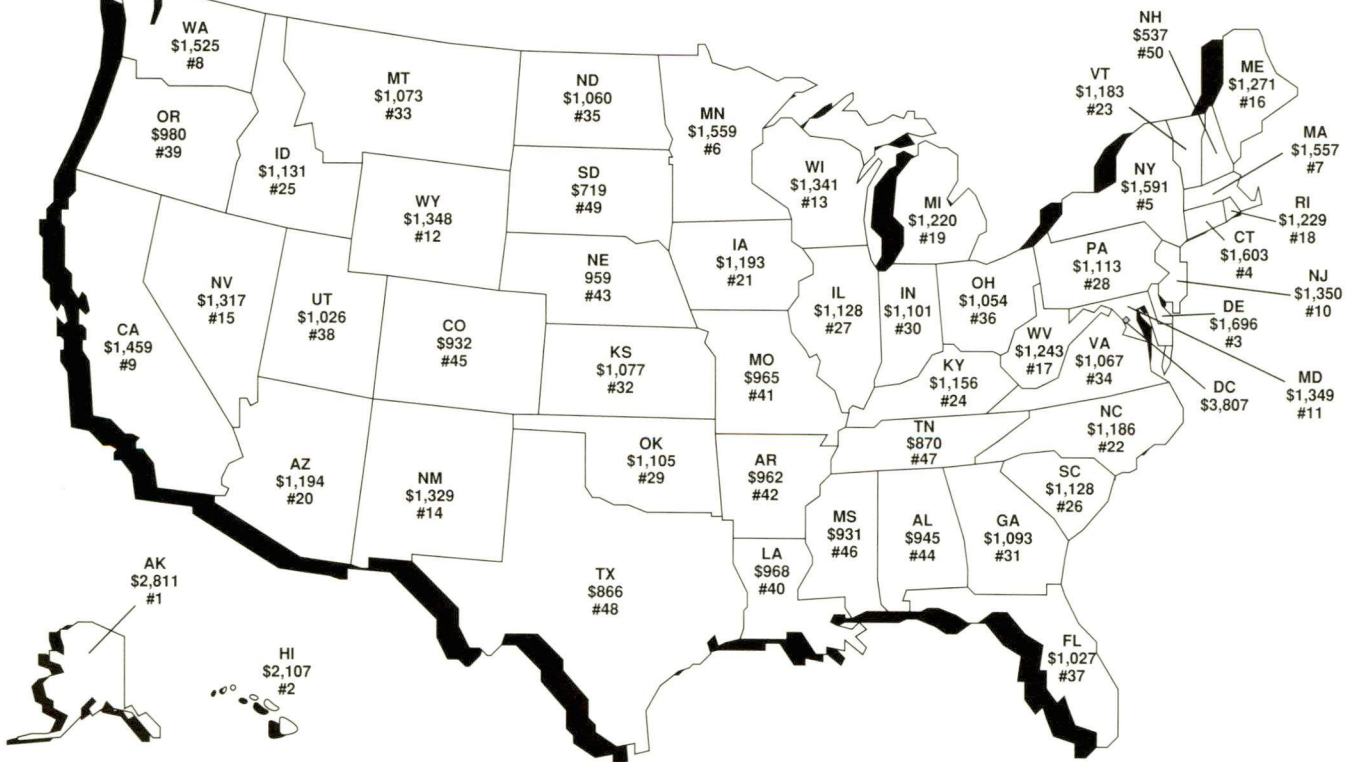
State tax revenues broke the \$300 billion mark for the first time in FY'90, rising 5.7 percent from their FY'89 level of \$284 billion, and providing 58 percent of total general revenue for the states. Severance tax, property tax, and death and gift tax grew the fastest, but most of the new funds were clearly due to persistent growth in collections from the mainstays of state government finance, personal income taxes and general sales taxes. They rose 8.2 percent and 6.6 percent respectively. Together these two tax sources accounted for more than 65 percent of the tax pie – \$99.7 billion from sales taxes and \$96.1 billion from personal income taxes. The third most pro-

digious revenue producer for state governments is corporate income taxes, which have been increasing rapidly and represented 7.3 percent of total collections in FY'90, or \$22 billion. The remainder of FY'90's revenue was garnered mostly from motor fuel taxes and licenses (see table 3 and figure 1).

Tax Burden Per Capita

Based on FY'90 tax collections, the average state tax burden per capita rose \$62, from \$1,148.52 in FY'89 to \$1,211.14 in FY'90. Alaskans pay the highest per capita taxes in the country, \$2,811.49 per resident. Hawaii (\$2,106.78), Delaware (\$1,695.59), and Connecticut (\$1,602.62) rank two-three-four in taxes per person. Taxpayers in New Hampshire (\$536.67), South Dakota (\$718.52), Texas (\$866.36), and Tennessee (\$870.38) will shoulder the lightest per capita state tax burdens (see table 4 and figure 2).

Figure 2
State Tax Collections Per Capita by State
Fiscal Year 1990



Source: Tax Foundation

line tax in the nation: the combined state-local tax ranges from 24.8 to 32.5 cents per gallon. Rhode Island (26 cents), Nebraska (23.71 cents), and Connecticut and Washington (23 cents) follow closely behind. Florida levies the lowest rate, 4 cents; but gasoline is also subject to a 6.9 percent general sales tax. Alaska and New York have the next lowest rates at 8 cents.

On cigarettes, the largest tax increases were enacted by Pennsylvania and the District of Columbia, which raised their rates 13 cents to 31 cents and 30 cents per pack respectively. Minnesota had been imposing the highest rate in the country — 43 cents per pack — but fell to second on October 1, 1991, when Connecticut's increase to 45 cents took effect. (See table 1 for more details.)

Additional Tax Burden Per Capita

Five states — California (\$6.6 billion), Pennsylvania (\$3.3 billion), New York (\$1.2 billion), Connecticut (\$1 billion), and Texas (\$799 million) account for more than 75 percent of the net \$17 billion tax increase (see table 2). However, a per capita analysis gives a clearer picture of what these additional tax revenues mean to the average taxpayer.

While California's \$6.6 billion increase is by far the largest total tax hike, the heaviest additional per capita tax burden will fall on taxpayers in Connecticut. There, a one billion dollar tax hike translates to \$315.02 in addi-

tional taxes for every man, woman and child. Eight other state governments will extract over \$100 per capita in new state taxes in FY'92:

Pennsylvania	\$277.91	Delaware	\$141.86
California	\$220.70	Rhode Island	\$130.35
Maine	\$216.63	Nevada	\$116.99
Vermont	\$160.10	Arkansas	\$112.60

Meanwhile, four states bucked the revenue-raising trend by passing measures that will bring in less revenue in FY'92, but not very much less. Montana will spare its taxpayers \$5.88 per capita; New Jersey, \$2.59 per capita, Michigan, \$1.08 per capita, and North Dakota, 16 cents per capita in FY'92. In all the states which passed any kind of new revenue measures this year, the average additional tax burden will be \$62.84 per capita for FY'92.

Trends in State Tax Collections

This year's \$17 billion increase in FY'92 taxes, following on the heels of the \$9.5 billion increase in FY'91, has perpetuated the 1980s' trend of escalating state taxes.

Moreover, state tax collections grew at an average rate of 8.6 percent in the 1980s, outpacing inflation by more than 3 percentage points and personal income by 0.6 percentage points. During the decade, state tax collections rose 119 percent, from \$137.1 billion in 1980 to \$300.5 billion in 1990. Personal

Table 3
State Government Tax Collections By Type
Fiscal Years 1980-1990
(\$Billions)

Type of Tax	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989 (a)	1990	Percent Change 80-90	Percent Change 89-90
Total	\$137.1	\$149.8	\$162.6	\$171.5	\$196.9	\$215.9	\$228.1	\$246.5	\$264.1	\$284.4	\$300.5	119.3%	5.7%
General Sales	43.2	46.4	50.4	53.6	62.6	69.6	74.8	79.2	87.1	93.5	99.7	131.0	6.6
Personal Income	37.1	40.9	45.7	49.8	59.0	63.9	67.4	76.2	80.1	88.8	96.1	158.9	8.2
Corporate Income	13.3	14.1	14.0	13.2	15.5	17.6	18.4	20.5	21.6	23.9	21.8	63.6	-8.8
Motor Fuels	9.7	9.7	10.5	10.8	12.4	13.3	14.1	15.7	17.2	18.1	19.4	99.6	7.2
Licenses	8.7	9.5	10.1	10.7	12.0	13.8	14.9	15.9	17.0	17.7	18.8	116.3	6.2
Other	3.2	3.4	3.7	3.9	5.2	6.0	6.4	7.1	7.4	7.7	7.8	142.8	1.3
Insurance	3.1	3.3	3.5	3.9	4.1	4.5	5.5	6.3	6.9	7.4	7.4	137.7	0.0
Public Utilities	3.4	4.3	4.9	5.7	5.9	6.2	6.0	6.0	6.2	6.2	6.5	93.5	4.8
Property	2.9	2.9	3.1	3.3	3.9	4.0	4.4	4.7	5.0	5.3	5.8	100.5	9.4
Tobacco	3.7	3.9	4.0	4.0	3.9	4.4	4.5	4.6	4.8	5.1	5.5	47.1	7.8
Severance	4.2	6.4	7.8	7.4	7.2	7.2	6.1	4.0	4.3	4.1	4.7	11.7	14.6
Death and Gift	2.0	2.2	2.4	2.5	2.2	2.3	2.5	3.0	3.2	3.5	3.8	86.7	8.6
Alcohol	2.5	2.6	2.7	2.7	2.9	3.0	3.1	3.1	3.2	3.1	3.2	29.2	3.2

(a) 1989 figures revised.

Source: Department of Commerce, Bureau of the Census; and Tax Foundation computations.

states which use a flat tax rate for all income.

Seven other states raised individual income tax rates: Rhode Island and Vermont, which base their income taxes on federal tax liability, hiked their rates; California, Massachusetts, Nebraska, and North Carolina raised their marginal rates for top income earners; and Pennsylvania raised its flat rate from 2.1 to 3.1 percent.

Rates in three states, Kansas, Oklahoma, and South Carolina, dropped for FY'92. South Carolina, as a result of prior legislation, enacted the final phase of income tax reduction, lowering the bottom marginal rate from 3 to 2.5 percent. Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming retain the distinction of being the only seven states which levy no individual income tax. Tennessee and New Hampshire exempt wages and salaries but tax income from interest and dividends.

Corporate Income Taxes

Six states — Arkansas, Kentucky, Minnesota, Nebraska, North Carolina, and Pennsylvania — raised corporate income tax rates for FY'92 while two states, Colorado and West Virginia, lowered them. Pennsylvania enacted the largest percentage increase, 44 percent, and consequently has the highest marginal corporate tax rate in the nation, 12.25 percent, slightly above Iowa's 12 percent. Iowa is followed by North Dakota (10.5 percent), and Minnesota (9.8 percent). (This ranking is based solely on marginal tax rates and does not take into account surtaxes or alternative minimum taxes, where imposed.) Five states continue to avoid corporate income taxes altogether: Nevada, South Dakota, Texas, Washington, and Wyoming.

Sales and Excise Taxes

Among the six states that increased their sales taxes for FY'92, California imposed the largest rate hike, from 4.75 to 6 percent. Connecticut, which had the highest sales tax in the nation last year, 8 percent, reduced its rate to 6 percent. As a result, New Jersey and Rhode Island now have the highest sales tax rates in the nation, 7 percent, followed by Minnesota and Washington, 6.5 percent. Five states — Alaska, Delaware, Montana, New Hampshire, and Oregon — do not impose a sales and use tax.

Twenty-three states enacted higher excises on motor fuels this year. California and Rhode Island enacted the largest increases, six cents per gallon. Hawaii added five cents per gallon and still imposes the highest gas-

Table 2
Projected Fiscal 1992 State Level Net Revenue Gains and Losses Resulting from 1991 Enactments

State	Revenue (\$Millions)	Per Capita (a)
Alabama	\$172.0	\$42.57
Alaska	1.0	1.82
Arizona	9.1	2.48
Arkansas	264.7	112.60
California	6,568.0	220.70
Colorado	-	-
Connecticut	1,035.5	315.02
Delaware	94.5	141.86
Florida	51.1	3.95
Georgia	-	-
Hawaii	48.0	43.31
Idaho	12.7	12.61
Illinois	817.0	71.47
Indiana	42.7	7.70
Iowa	13.6	4.90
Kansas	-	-
Kentucky	-	-
Louisiana	315.0	74.65
Maine	266.0	216.63
Maryland	90.1	18.84
Massachusetts	-	-
Michigan	(10.0)	(1.08)
Minnesota	287.7	65.76
Mississippi	-	-
Missouri	-	-
Montana	(4.7)	(5.88)
Nebraska	17.3	10.96
Nevada	140.6	116.99
New Hampshire	61.7	55.62
New Jersey	(20.0)	(2.59)
New Mexico	27.1	17.89
New York	1,200.0	66.70
North Carolina	616.9	93.07
North Dakota	(0.1)	(0.16)
Ohio	122.1	11.26
Oklahoma	-	-
Oregon	92.6	32.58
Pennsylvania	3,302.0	277.91
Rhode Island	130.8	130.35
South Carolina	10.6	3.04
South Dakota	-	-
Tennessee	5.5	1.13
Texas	799.0	47.04
Utah	4.9	2.84
Vermont	90.1	160.10
Virginia	33.2	5.37
Washington	10.7	2.20
West Virginia	-	-
Wisconsin	284.7	58.20
Wyoming	-	-
District of Columbia	44.5	73.32
	\$17,048.2	-

(a) Based on latest available population data, June 1990. Source: National Conference of State Legislatures, and Tax Foundation survey of revenue departments, legislative officials, and governors' offices.

Table 4

Total State Level Tax Collections Per \$1,000 in Personal Income and Per Capita Tax Burden

Fiscal Year 1990

State	Per \$1000 of Income	Rank Per Capita	Per Capita (a)	Personal Income (b) (\$Millions)	Total Tax Revenue (\$Millions)
Total	\$64.87	-	\$1,211.14	\$4,632,380	\$300,488.6
Alabama	63.76	44	945.29	59,907	3,819.5
Alaska	129.20	1	2,811.49	11,969	1,546.4
Arizona	73.27	20	1,194.13	59,732	4,376.8
Arkansas	67.65	42	961.80	33,423	2,260.9
California	70.16	9	1,458.98	618,850	43,419.2
Colorado	49.57	45	931.71	61,916	3,069.4
Connecticut	63.20	4	1,602.62	83,355	5,268.0
Delaware	84.62	3	1,695.59	13,349	1,129.6
Florida	55.27	37	1,027.17	240,459	13,289.5
Georgia	64.49	31	1,092.62	109,765	7,078.2
Hawaii	104.02	2	2,106.78	22,446	2,334.8
Idaho	74.61	25	1,131.11	15,262	1,138.7
Illinois	55.55	27	1,127.72	232,071	12,890.5
Indiana	65.26	30	1,100.55	93,494	6,101.6
Iowa	69.17	21	1,193.15	47,897	3,313.1
Kansas	59.89	32	1,077.26	44,562	2,669.0
Kentucky	77.44	24	1,156.13	55,019	4,260.7
Louisiana	67.29	40	968.42	60,730	4,086.7
Maine	73.90	16	1,271.14	21,120	1,560.9
Maryland	61.70	11	1,348.99	104,543	6,450.1
Massachusetts	68.78	7	1,557.26	136,226	9,369.1
Michigan	66.52	19	1,220.34	170,534	11,343.4
Minnesota	83.21	6	1,558.65	81,948	6,819.3
Mississippi	73.11	46	931.08	32,770	2,395.9
Missouri	55.16	41	965.23	89,535	4,939.2
Montana	71.04	33	1,073.36	12,074	857.7
Nebraska	55.66	43	958.53	27,182	1,512.9
Nevada	67.85	15	1,317.39	23,335	1,583.3
New Hampshire	25.82	50	536.67	23,060	595.3
New Jersey	54.06	10	1,349.76	193,008	10,433.9
New Mexico	93.43	14	1,329.34	21,556	2,014.0
New York	72.38	5	1,590.54	395,336	28,614.6
North Carolina	73.23	22	1,186.48	107,403	7,864.7
North Dakota	69.48	35	1,059.97	9,745	677.1
Ohio	60.34	36	1,054.32	189,537	11,436.4
Oklahoma	71.57	29	1,105.31	48,581	3,476.9
Oregon	57.13	39	980.15	48,762	2,785.9
Pennsylvania	59.59	28	1,112.61	221,850	13,219.7
Rhode Island	65.23	18	1,229.05	18,906	1,233.3
South Carolina	74.73	26	1,128.40	52,646	3,934.4
South Dakota	45.27	49	718.52	11,047	500.1
Tennessee	55.09	47	870.38	77,052	4,245.0
Texas	51.70	48	866.36	284,678	14,716.5
Utah	72.87	38	1,026.20	24,263	1,768.0
Vermont	67.85	23	1,183.00	9,812	665.7
Virginia	54.02	34	1,066.77	122,178	6,600.5
Washington	80.88	8	1,525.29	91,774	7,423.1
West Virginia	90.44	17	1,243.25	24,655	2,229.7
Wisconsin	76.59	13	1,340.57	85,620	6,557.7
Wyoming	82.23	12	1,348.39	7,438	611.6
Exhibit: Dist. of Col.	157.43	-	3,806.74	14,675	2,310.3

(a) Population as of June 1990.

(b) Personal income is the sum of the State estimates. It omits the earnings of Federal civilian and military personnel stationed abroad and of U.S. residents employed abroad temporarily by private U.S. firms.

Source: U.S. Department of Commerce, Bureau of the Census, Bureau of Economic Analysis, and Tax Foundation computations.

Taxes Per \$1,000 of Personal Income

Taxpayers paid a national average of \$64.87 in state level taxes per \$1,000 of personal income earned. The average effective rate, therefore, of taxes per \$1,000 of personal income is 6.49 percent. Thirty-one states and the District of Columbia surpassed this national average rate. Alaska, second only to the District of Columbia, led the states with an effective rate of 12.9 percent, nearly double the national average. By comparison, taxpayers in New Hampshire paid 2.6 percent of their personal income in state taxes, only one-fifth of Alaska's rate. The ten states with the highest taxes as a percentage of personal income are:

Alaska	12.9	Minnesota	8.3
Hawaii	10.4	Wyoming	8.2
New Mexico	9.3	Washington	8.1
West Virginia	9.0	Kentucky	7.7
Delaware	8.5	Wisconsin	7.7

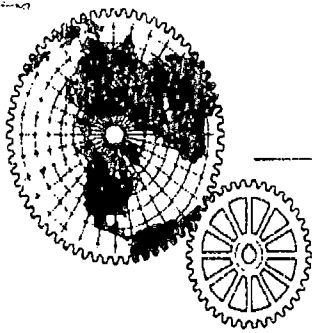
The lowest percentages are paid by taxpayers in:

New Hampshire	2.6	New Jersey	5.4
South Dakota	4.5	Tennessee	5.5
Colorado	5.0	Missouri	5.5
Texas	5.2	Florida	5.5
Virginia	5.4	Illinois	5.6

Outlook for State Taxpayers

While Americans are struggling to make ends meet in a recessionary economy, state legislatures have handed them a whopping \$17 billion tax hike. Despite the size of the increase, demands for more state-level funds are already being heard, as state governments try to simultaneously keep up with federal spending mandates and satisfy their own wish-lists for higher spending. This perpetuates a trend of the 1980s – higher taxes and higher spending at the state level. And with no robust recovery in sight, it is a trend which will cause an increasing amount of pain to state taxpayers.

The Tax Foundation, a nonprofit, nonpartisan research and public education organization, has been monitoring tax and fiscal activities at all levels of government since 1937.



POLYCONOMICS, INC.

Political and Economic Communications

November 4, 1991

THE BUSH RECESSION

Morris ("Hawkeye") Mark of Mark Partners, one of our Wall Street clients, called us at 3 p.m. Friday, pointing out that at 2:46 p.m. the Dow was up five points in a strong market and the long bond was up a half point. At 2:51 p.m., the Dow was off 19 and the bond down a quarter. What kind of typhoon could, in five minutes, blow 24 points off the Dow and three quarters of a point from the 30-year Treasury? At 2:46, says Morris, a report came across his screen that President Bush, in Texas, was insistent that the Fed lower interest rates! It's bad enough that the bond market quivers and the dollar slides practically every time a reporter puts a microphone under the nose of Nick Brady or Michael Boskin. For the President to be flogging the Fed on the eve of its FOMC meeting and Treasury refunding is unconscionable, further evidence of the bankruptcy of this Administration on economic policy.

Before Friday afternoon was out, we talked to three other clients and an official at the Fed in Washington who also noted the connection between the President's comments and the bond selloff. As we know, the financial press, with rare exceptions, is incapable of making such connections on its own, I called an editor at *The Wall Street Journal*, and an item making the connection appears at the bottom of the editorial page today. There is a bit of a discrepancy on the exact times, with the broad tape carrying a headline, "Bush Calls For Lower Interest Rates, Fitzwater Says," logged at 2:32. But there should be no doubt that Typhoon Bush was responsible for Friday's selloff. Two weeks ago I yelled at Boskin for his Fed bashing, pointing out that the 30-year Treasury takes a nosedive whenever he's quoted. He claims to be taken out of context. He is taken out of context at least twice a week. It of course does no good to explain to the Treasury Secretary -- as I did in his office early in 1989 -- that when you are trying to persuade your creditors to lend you lots of money, you should not be threatening to cheat them through an inflation. Ten days ago I wrote the President a three-page letter, urging him to make a personnel change at Treasury if he hopes to get the economy on track. I, of course, sent a copy to Secretary Brady as well.

The only thing holding together the economy, as much as it stinks, is the good sense at the Federal Reserve to continue resisting the pleas of the Administration to inflate. The fed funds rate continues to drift lower, but only coincident with a decline in the price of gold, now at \$356. The Fed is clearly not adding liquidity faster than the market is demanding it. There is simply less demand for liquidity for transaction purposes because there are fewer transactions. The dollar is being hammered against the Deutschemark only because the Bundesbank is not taking seriously the sharply declining gold price in *D-mark* as a demand for more liquidity in that currency, due to the continuing, surprising expansion of the East German sector.

In his Texas speech Friday, President Bush did a lot of yelling and screaming about how the Democratic Congress has prevented the U.S. economy from expanding. Alas, I now agree with Senate Majority Leader George Mitchell: The Bush Administration is, at least in fiscal policy, looking more like the Hoover Administration. As much as the President favors economic growth *in principle*, he has for three years in a row made the budget his highest priority. It was possible to blame the Democrats in 1989. In 1990, it was possible to divide the blame, as the White House and Congress cut their budget deal. In 1991, the President has once again decided the preservation of his Budget Agreement is more important than negotiating a growth package with the Democrats. He has taken three called strikes, the bat never leaving his shoulder, and now he would like a fourth pitch in 1992. Maybe. In *The Wall Street Journal* this morning, we read that Budget Director Richard Darman believes there may be a capital gains tax cut next year, if the economy hasn't recovered on its own!

Two weeks ago I called a Pennsylvania client who had introduced me to Richard Thornburgh in 1978 when Thornburgh was running for governor. I told him I didn't think Thornburgh could win his race for the Pennsylvania Senate seat as long as he was defending the economic policymaking of George Bush. As much as the people of Pennsylvania might prefer him to Harris Wofford, a traditional liberal Democrat, it would send the President the wrong signal if they elected Thornburgh. On the other hand, if Thornburgh, even in the closing days of his campaign, aligned himself with the growth faction in the Administration, publicly disagreeing with the Hooverian policies of Brady, Darman and Boskin, the voters would almost have to vote for him, to send that signal. David Duke would not have defeated Republican Governor Buddy Roemer in Louisiana this September if Roemer had given the voters the slightest opportunity to use him as a protest message to the Bush Administration. With 70% of the nation now responding to polls saying the country is on *the wrong track*, why would anyone line up behind candidates who are lined up behind George Bush?

The *Journal* carried an article last week indicating that Art Laffer and I have given up on President Bush and have now embraced former Gov. Jerry Brown as the supply-side "torchbearer." The article was the result of Brown telling the reporter that he has consulted us for advice. (The reporter, whom I've known for more than 25 years and have never, ever telephoned, described me in his article as a "self-promoter.") The same article points out that I've also been trying to persuade New York's Mario Cuomo to jump into the race, which suggests I'm awfully fickle or about to commit political bigamy. The fact is that *at the moment*, we have no choice but to look for an alternative to President Bush, to talk to any Democrat who looks to us for counsel, or to any Republican that might be thinking of jumping into the GOP primaries next year. I've not spoken to Art Laffer in several years, but I understand it is as imperative for him as it is for me [as it is for all of us] to find a political solution to the mess the country is in. If we can't find the solution on the GOP side, there is only one other party left.

In his front page column in *Barron's* this week, Editor Alan Abelson, who read the *Journal* article, finds all this very amusing. The column opens: "Jerry Brown and Jude Wanniski. Governor Moonbeam and Mr. Moonshine. Together at last. It was destined to happen: The conjunction of touchy-feely politics with feel-good economics. There hasn't been so perfect a union since Laurel met Hardy."

Actually, Jerry Brown and I have not even held hands yet, let alone committed strange bedfellowship or political union. We don't know each other well enough. But it might come to that. It's always possible President Bush will get back on track, with a little marriage counseling. Even if he doesn't change course, at the moment he's still more likely to be re-elected than any of the alternatives that have emerged among the Democrats. On matters foreign and domestic, he is still more likely to do the right thing more often, eventually, than the opposition we've seen to date. Foreign economics excepted, his foreign policy team is as good as it gets. He has been, and remains, excellent on trade issues. His appointments to the Supreme Court, especially that of Clarence Thomas, have been laudable. We also cannot forget that he reappointed Alan Greenspan to the Fed, over the objections of Nick Brady, and that it is Greenspan's resolve which is holding things together on the monetary side. Unfortunately, when you add up all his good points and throw in all his good intentions, the fact remains that the economy stinks, it's not getting any better, and he's to blame.

Jude Wanniski

THE DISTRICT LINE

The Cornrow Tangle

Taalib-Din Abdul Uqdah Leads the Fight for the Right to Braid

"All I need," argues Taalib-Din Abdul Uqdah, "is shampoo and conditioner, a comfortable place to sit, and a comb." But the outraged proprietor of Cornrows & Co.—a salon that specializes in hairweaving, braiding, and natural haircare for the African-American woman—charges that city regulators are requiring him to have much more than that. All Uqdah wants to do is make beautiful braids and offer an alternative aesthetic for black women. Instead, he's waging a pitched political battle with D.C. regulators, officials, and cosmetologists, to save his business and change what he believes is an outdated, even discriminatory, law.

"The present cosmetology act is outdated," rages Uqdah, who owns the 12-year-old Cornrows & Co. with his wife, Pam Ferrell. "[The law] hasn't been revised since 1938, back when African-Americans weren't even allowed in beauty salons. It's a congressional law. With any law that was passed in '38, it was not the intention of Congress to include black people in general, and hair braiding in particular."

Current city statutes, Uqdah contends, require would-be braiders to complete lengthy, expensive programs offered by cosmetology schools; programs that teach budding beauticians how to straighten hair with sodium hydroxide, how to curl hair with ammonium thioglycolic acid, but not how to braid. His solution—a separate license for braiders—would open up career opportunities for the many D.C. women who cornrow in their homes and would win credibility for 'dos that have come under attack.

It would also help Uqdah out of a jam. For the past decade, he has refused to obtain a license and has defied efforts by the D.C. Department of Consumer and Regulatory Affairs (DCRA) to close down his shop. DCRA recently slapped him with a \$1,000 fine for "operating an unlicensed beauty shop" and failing to have a licensed manager on the premises. Uqdah appealed the DCRA decision, which was upheld by the administrative court of the D.C. Board of Appeals and Review.

Uqdah has no intention of paying the fine. He remains philosophically opposed to the standard cosmetology-school curriculum—which, he asserts, encourages black women to reject their own assets and to destroy their hair.

"Our purpose is to redefine standards of beauty," Uqdah declares, "to re-educate the African and African-American woman on proper care and maintenance of her hair and that of her child." That means rejecting perms, relaxers, curls, and other artificial treatments and accepting the "nappy, kinky, overcurly, thick, coarse, can't-get-a-comb-through" hair with which most black women are born. Braiding, he argues, is the ideal treatment for African-American hair.

"I'm for social change," Uqdah declares, "that's what braiding is."

Cornrows, woven and worn primarily by African-American women, arrange the hair in neat rows of thin, tightly knit braids that hug the scalp. A braider's skillful fingers work like knitting needles to intertwine hair into loops and twists, then lay them out in swirling patterns—ornate, intricate designs that can take as much as six hours to complete. Styles are sometimes adorned with beads or loose strands of colored hair, synthetic or real. When hair is too short or damaged, braiders add extensions to enhance a person's own tresses.

The steady popularity of the hairstyle lends urgency to Uqdah's crusade. In addition to Cornrows & Co., located at 5401 14th



D.C. regulations have Uqdah tied up in knots.

St. NW, at least two other D.C.-area salons specialize in braiding: Twists and Turns on Georgia Avenue NW, and Uniquely You Braiding Gallery in Riverdale, Md. According to Uqdah, Cornrows & Co. has grossed over \$2 million in the last 10 years, and his five braiders do 25 to 30 heads per day. In 1988, he told *City Paper* that his client base was 6,000; this year, he ups that number to "well over 20,000 people."

But Uqdah knows that the style does not enjoy universal acceptance. Far from it: Corporate America and other forces of assimilation regard these tidy cranial furrows as a hostile expression of "blackness." Uqdah's attempts to protect a woman's right to be braided led him in 1988 to pay the legal fees of three women who sued the Hyatt and Marriott hotels for requiring them to abandon their cornrows. The women, patrons of Cornrows & Co., are just a few of many victims of black and white employers' anti-braiding policies. "Those officials did not take what we do seriously," says Uqdah, a large, vehement man in his late 30s.

Even some African-Americans, he acknowledges, react with surprising hostility toward cornrows, Africa's 4,000-year-old indigenous hairstyle, brought to this country by slaves. These victims of mainstream fashion, Uqdah believes, see braids as "part of our history that they would like to forget" and favor chemically treated "Caucasian" coifs.

"The biggest problem for most folk is they have confused integration with assimilation," says Uqdah.

Taking his cause to the D.C. Council in 1985, Uqdah persuaded Councilmember Charlene Drew Jarvis (D-Ward 4) to draft legislation that would formally elevate braid-

ing to a separate industry with its own regulations, licensing avenues, and training academies. Hearings were held on the Jarvis bill in May 1990 before the Committee on Consumer and Regulatory Affairs. Although the bill died in committee, Jarvis reintroduced it in July of this year, and it's currently awaiting review.

More than an economic necessity, Uqdah urges, a pro-braiding law would mark a political breakthrough for the District. "If the District passes a hair-braiding law, it will be the first out of all states," he exhorts. "So with the struggle for statehood, that would give [D.C.] some credibility."

"If you change outdated laws, other states will look to you and say the District is responsible."

Currently, to become a licensed braider, an individual must learn about everything but the craft itself. Like any other stylist, a nascent braider must spend nine months completing 1,500 hours of instruction at a local cosmetology school like the D.C. Beauty Academy or the National Institute of Cosmetology, paying from \$3,000 to \$4,000. There, students learn how to shampoo hair, press hair with a hot comb, create wet curls, dye and bleach hair, chemically straighten it, and do manicures and facials.

What they don't learn, Uqdah charges, are the skills—and hazards—of braiding. A motivated student can receive cursory braiding instruction, but it's not a required part of the curriculum nor included on the board exam. According to Uqdah, the industry's cavalier attitude toward braiding leads to problems like *traction alopecia*—more commonly known as balding—which results when a hairdresser braids hair too tightly or too soon after it's been chemically treated.

For the clients of living-room braiders, who avoid the exam entirely, the hazards can include infections from dirty combs and unwashed hair.

Uqdah's solution is separate braiding academies—similar to the unofficial one he operates as part of his own business—where students would complete a 750-hour minimum program, learning cornrowing techniques as well as a basic knowledge of chemicals in order to recognize their effects. Currently, Uqdah offers a three-month, \$2,400 braiding course that, he says, trains braiders without forcing them to learn "offensive" procedures. Without credentials, however, he can offer students nothing but a certificate and a fairly certain guarantee that they can find full-time work either with him or with another salon.

The founders of the D.C. area's two other braiding salons studied under Uqdah, but bowed down and took the board's cosmetology exam. Cecilia Hinds, founder and owner of Uniquely You Braiding Gallery, says that Uqdah's reform would have made setting up a shop easier for her five years ago.

"I tried to get licensing for braiding," says Hinds, "but I had to go through the normal channels.... There are a lot of braiders that would like to be legit that don't want to go to cosmetology school." A new law aimed explicitly at braiders, she says, would allow them to set up "bona fide businesses."

Licensing, Uqdah says, will give home-braiders "a legitimate way to come out of the basement, to come off the back porch and start their own franchise."

In large part, Uqdah's current crusade is aimed at preserving his business. Staunchly resisting the current licensing process, he has contacted officials representing both former Mayor Marion Barry and Mayor Sharon Pratt Dixon, asking them to call off the DCRA hounds—but to no avail. In addition to DCRA's efforts to shut him down, both the Board of Cosmetology and the Board of Barbers oppose the Jarvis' Uqdah bill. They charge that Uqdah and other braiders should have formal cosmetology licenses.

The two boards have authored their own bill—which rather vaguely adds braiding to the "definition" of cosmetology but does not set up a separate license. Under this measure, Uqdah and his salon would still be violating the law.

But breaking the law, as Uqdah sees it, is a necessary tactic. Indeed, a noble tactic. "They told Rosa Parks and all those people down in Montgomery: 'It's the law.' They told us to sit on the back of the bus. I'm not sitting on the back of the bus. I'm not buying into that old nonsense." Not only does he plan to stay open; he wants to spread the wisdom. He and his wife have recently distributed "Gallery of Art Styles," an 80-page, full-color catalog featuring 55 different hairstyles. Soon to come is *Thunderhead*, a video that teaches parents how to dress their children's hair that, they hope, will reach people around the world—who knows, even alter the image of the nation's capital.

"Wouldn't it be nice for a change," Uqdah speculates, "for Washington to be known as the braiding capital of the world instead of the murder capital of the world?"

—Ruth M. Bond

Ogata Journal

Japan

Japan's Unlikely Rebels: The Fabled Rice Farmers

By DAVID E. SANGER
Special to The New York Times

OGATA, Japan — When this village on the edge of the Japan Sea was created as a giant national experiment 25 years ago, it was called frontier land in a nation with no frontiers.

Farmers were lured from all over the country with promises of vast, cheap land and a stake in a new Japan. It was here, they were told, that the Japanese would teach themselves how to rival America's biggest farms and ease the country's perpetual worries about its over-reliance on foreign-grown food.

It did not turn out that way. In the new Japan, fiber optics and computers proved a lot more important than rice and soybeans. A generation of Japanese fed on McDonald's hamburgers eat far less rice than their parents did, and now Japan produces much more rice than it can consume. And that has started a series of events that have transformed Ogata from a rural utopia into a bitterly divided community.

At its core, the argument centers on those who think the Japanese Government is saving the fabled Japanese rice farmer — descendants of the men extolled in song and swathed in nationalistic myths — and those who think it is dooming him to extinction.

Farmers Flout the Law

Ogata is the site of a rice rebellion, one Tokyo is eager to put down before it spreads throughout the country.

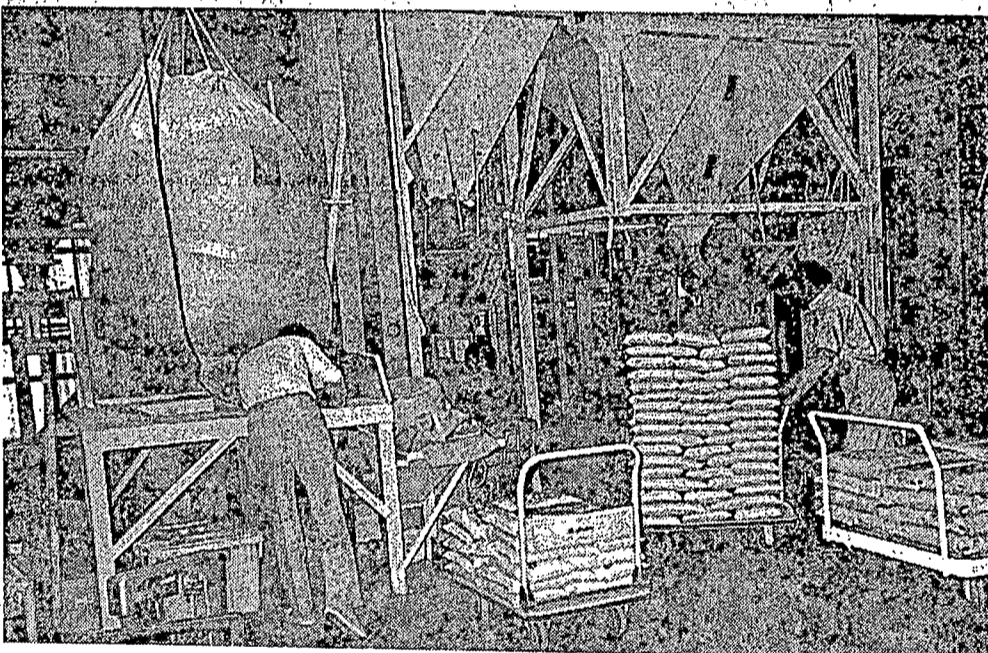
Nearly half the farmers here have openly flouted the law that requires them to keep their rice production within strict quotas and to sell their entire crop to the Government, at Government-set prices. It is then sold to long-suffering consumers at upward of four or five times the world market price.

Until now, the price-fixing system has worked because Japan has imposed a ban on all foreign rice, a perennial irritant in its relations with the United States.

But on the edge of town here, Kyoji Suzuki and his fellow farmers have decided to produce as much rice as they want and sell it for whatever they can. "We've lived under the thumb of the Government for years now," Mr. Suzuki said the other day, while his colleagues bagged their rice for direct delivery to their customers, evading the Government system. "We've had enough."

Last year, Mr. Suzuki said, his band of rebel farmers sold \$4 million worth of rice, despite what he called a campaign of harassment by Government agents.

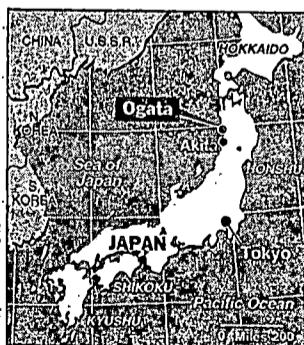
Grass-roots rebellions of any kind are rare in Japan, and not surprisingly Mr. Suzuki has not quite got the hang of being a free marketeer. His



David E. Sanger/The New York Times

Japanese rice farmers are required to keep production within strict quotas and to sell at set prices to the Government. Rice is then sold to consumers at

an extreme mark-up. In Ogata, at a "rebel" rice processing operation, farmers are evading the system and selling directly to Japanese families.



The New York Times

A rice rebellion in Ogata has the Japanese Government worried.

rice is scarcely any cheaper than the Government's, and he is not eager for foreign competition either. But price is not the issue, he says. He argues that the real problem is that Japan's overregulated agricultural markets are an example of economic planning gone wild.

He and his friends are getting a lot of visitors lately who agree, mostly

from foreign embassies in Tokyo. The diplomats are drawn here because they see the Ogata rebellion as evidence for their case that Japan must give in to the inevitable, and crack open its market for rice.

It is a move being desperately opposed by farmers, the Agriculture Ministry and the many politicians who depend heavily on Japan's extraordinarily influential farm vote.

If Japan sticks to its position, many here fear, it will be blamed for scuttling the global trade talks known as GATT — something that Japanese officials fear as much as farmers' protests. The new Prime Minister, Kiichi Miyazawa, has hinted recently that he will continue Japan's hard line against opening the rice market.

'Splitting Into the Heavens'

Among the many disputes that trouble relations between America and Japan, rice can seem pretty trivial. Measured in dollars, it pales next to automobiles or supercomputers, and one could argue that it is hardly worth the passion expended by either side. But it is futile to argue that point here: The Government has promoted much of the mythology about how Japan has long fed its own and how its "food security" would be threatened by imports.

Here in Ogata, the farmers who have abided by Japan's rules say foreigners and next-door-neighbors

alike are risking the ruin of rural Japan.

"They are spitting into the heavens, and it will fall back on them," said Seiki Miyata, the Mayor of Ogata, which was created by filling in Japan's second largest lake. "Japan is not prepared to liberalize these markets. If we do, it will destroy rice growing, and with it all of our villages and our towns."

In truth, Japan's farming villages and towns are fading out already. At the agricultural high school in Akita, there were 286 graduates in March. "Forty-seven of them went to university," the principal, Yoshimitsu Ikeda, said the other day. "The rest went to work. But the number who started to work as farmers is zero."

Eventually some of those who left back to agriculture if they take over the family farms. But they hesitate. "We try not to say we will be farmers, because the image is not so good," said Takashi Tamura, a student at the school. "We're told it is not so easy to find a wife."

Meanwhile, in the country that celebrates "wa," or harmony, Ogata remains a decidedly unharmonious place. At the new year's party, opposing groups will not eat at the same table.

"We have two villages really, existing side by side," says Shinichiro Sakamoto, one of those who has vociferously argued against opening the market. "These days, we don't talk to each other very much."

SEMI-ANNUAL SALE!