Dirck Halstead — Liaison

The Nature Of The Reagan Administration's Revenue Problem

TAX & TAX

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■ IN HIS 1964 television speech on behalf of Presidential candidate Barry Goldwater, Ronald Reagan warned: "No nation in history has ever survived a tax burden when it reached a third of its national income. Today [*in 1964, remember*] 37 cents out of every dollar earned in this country is the tax collector's share, and yet our government continues to spend $17 million a day more than the government takes in."

As bad as this situation was seventeen years ago, the tax collector's share has since risen to nearly fifty cents of every dollar earned, and deficit spending has been proceeding at the incredible rate of some $150 million a day — almost ten times what it was in 1964!

We are being driven to the wall. Assuming inflation and tax-bracket creep remain only at the level of the 1970s for another decade, a worker who made $10,000 in 1970 will have to make $55,941 to stay even; one who made $20,000 will have to earn $118,689; and, to equal $40,000 you will need an income of $231,024.

Indeed, in recent years, federal spending and taxing have been growing at rates of between twelve and sixteen percent a year. Gross federal tax receipts for Fiscal 1980 reached over half a trillion dollars — a 12.8 percent increase over the previous year. In the largest tax categories for 1980, individual income-tax payments rose 14.3 percent and Social Security taxes grew by 13.9 percent. The figures for the current Fiscal Year are expected to be even worse.

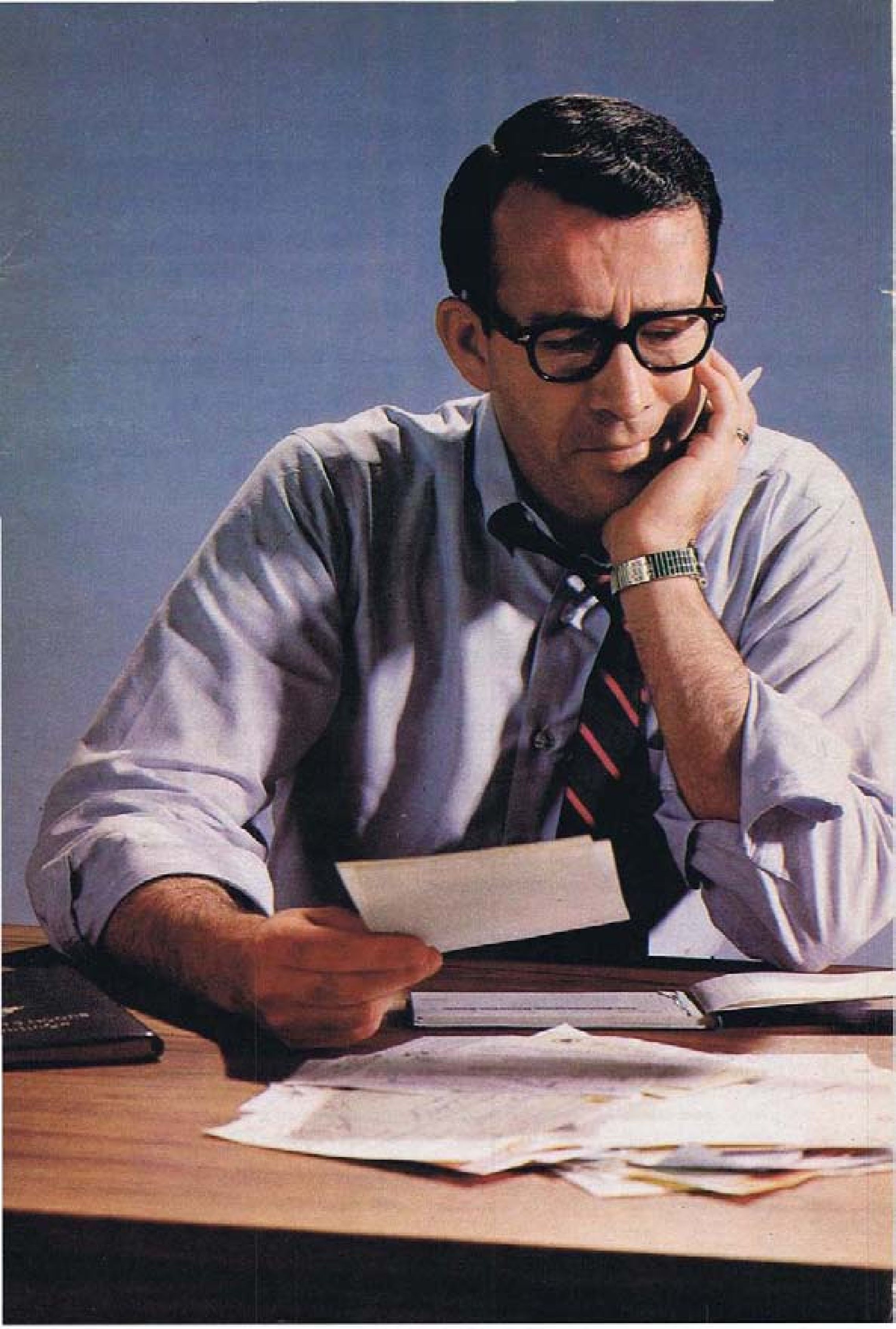
Since Ronald Reagan's warning in 1964 we have also experienced sustained double-digit currency depreciation, stagflationary recessions, a decline in the growth rate of national productivity, and we now face the near-term possibility of a trillion-dollar National Debt. Clearly, the economic and political crises we suffer today make 1964 seem like the days of milk and honey.

President Reagan evidently grasps the urgency of the national economic problems he has inherited. In what might be remembered as one of the best Presidential speeches ever given he told the American people of the seriousness of our situation in his first nationally televised address. He spoke simply and powerfully, explaining how the purchasing power of the dollar has been reduced, and telling how this is part of the price we pay for allowing the government to spend more than it takes in as receipts. It was quite an economics lesson, and so well crafted that even the merest tyro would upon hearing it understand the depth and causes of our malaise. Unfortunately, he almost immediately called upon Congress to approve a $50 billion increase in the National Debt.

One of the economic facts of life that Americans must learn is that the cost of this colossal spending spree must be paid. There are three, and only three, ways in which the federal government can finance its spending; it must either tax, borrow, or print the necessary money. While the first two means of finance are available to the state governments as well, only the federal government claims the legal right to pay its debts by "printing" fiat money.* If you and I tried to pay our debts by printing up dollar bills we would be hauled in and booked as counterfeiters trying to get something for nothing at the expense

*Of course, since 1913 the federal government has not printed the money itself; it has the government-chartered Federal Reserve expand the money supply at an increasingly high service charge paid each year out of direct taxes. But, whether the legitimized counterfeiting is done by a privileged central banking monopoly or by the government itself, the American people wind up paying the bill.

H. Armstrong Roberts



President Reagan emphasized to the Congress that we must have substantial cuts in the rate of taxation, calling for a 30 percent reduction over three years. Mr. Reagan then called for what he said were reductions in spending, but he was also proposing to saddle us with a potentially fatal inflationary deficit of $45 billion.

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of others. But, when the federal government does essentially the same thing, it is called "monetizing the debt" and no one goes to prison for it. At least not yet. Meanwhile, as Robert Lee reports in his article on "The Debt" in this month's issue of AMERICAN OPINION, the huge interest payments on this are now approaching $100 billion a year.

Deficit spending and resultant inflation provide Congress with a sneaky way of increasing taxes on the American people without having explicitly to vote for a tax increase — always a politically risky action. The synergistic effects of the double scourge of inflation and the graduated income tax are plundering us blind. In his latest book, *A Time For Action,* former Secretary of the Treasury William Simon drives home the point:

"As inflation pushes nominal incomes ever higher, progressive taxes take an ever bigger percentage of that income for the government. To pick a simple example, if a family of four had an income of $15,000 in 1970, federal taxes absorbed about 15 percent of its earnings. In 1980, after prices had slightly more than doubled, this family would need a $30,000 income to be nominally even with its previous income. But at this level it will have to fork over almost 21 percent of its earnings to the IRS. So even if this family had managed to double its income, it has not really stayed even. To have the same *after-tax* income, it would need earnings of $34,349."

If that $30,000 a year man got a pay raise of fifteen percent ($4,500) at the beginning of 1980, he actually wound up with $445 less purchasing power by year's end than he started with. "Bracket creep" would have pushed his marginal tax bracket to forty-nine percent from forty-four, while the year's twelve percent inflation rate reduced his buying power another $2,945. Add higher Social Security, state, and other taxes, and the picture was even more dismal.

Meanwhile, according to the I.R.S., more than two million tax returns now fall into the fifty percent bracket with taxes on $14,500 or more for singles and $60,000 or above for couples. That is more than quadruple the number of people in the fifty percent bracket in 1973.

William Simon explains what will happen to us if we project the trends of the past decade into the future. "Extend the process one more decade and the effects are startling," he observes. "Assuming the inflation rate experience in the '70s, with all the present tax laws in place, taxpayers will find themselves sprinting ever

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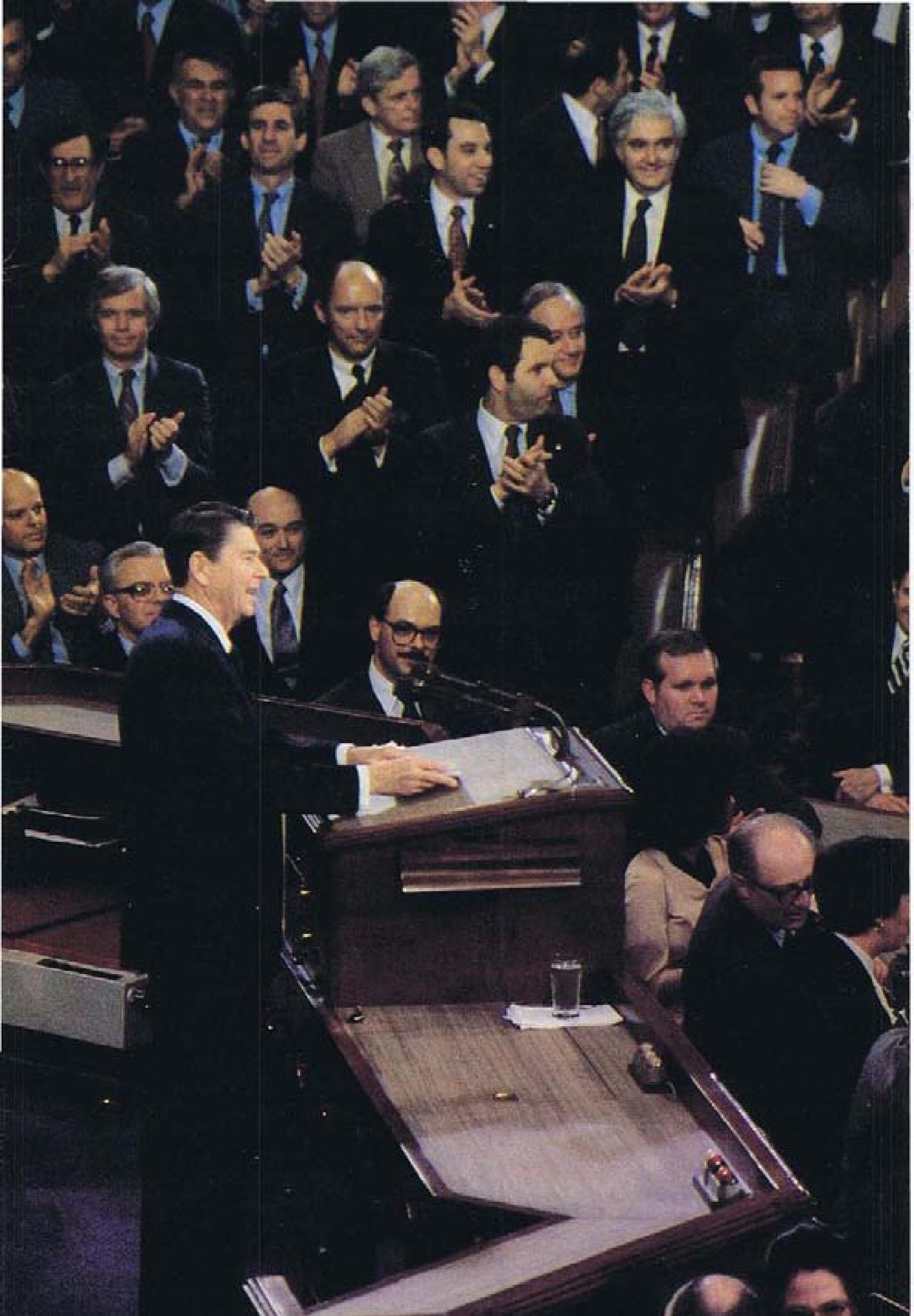

faster on a treadmill. Someone who made \$10,000 in 1970 will have to make \$55,941 in 1990 just to stay even; someone who made \$20,000 will have to earn \$118,689; and someone who made \$40,000 will need \$231,024. If you are in one of the 1970 brackets listed and don't think your income is going to grow this much in the next decade, you are one of those who is being chewed up by our present system of chronic inflation and automatic tax hikes."

In 1979 a wage earner could receive as much as a thirteen percent raise and yet actually lose purchasing power due to the insidious effect of inflation and being boosted by the progressive tax tables into a higher bracket. According to Congressman Philip Crane (R.-Illinois), "Every one percent rise in inflation increases taxes by one and three-quarters percent" due to this "bracket creep." With current inflation levels and taxing policies, this works out to an increase of between one and one-and-a-half billion in added revenue for each one percent rise in the Consumer Price Index. According to David Keating, a spokesman for the National Taxpayers Union, the increase in federal revenues due to bracket creep alone from 1980 to 1981 was about fifteen billion dollars. In addition, however, because as much as forty percent of federal spending is directly or indirectly indexed to inflation, every percentage point increase in inflation increases spending for indexed programs by another \$2.2 billion. Direct indexing alone will cost a total of about \$23 billion in Fiscal 1981. The increase in the dollar amount of federal revenues will of course change, depending on the inflation rate, how the tax laws are altered, and which federal programs will continue to be tied to the Consumer Price Index.

What is clear is that all of this gives the politicians a perverse incentive to continue inflation. The more they inflate, the more revenues pour into the coffers of Big Government. As Congressman Philip Crane observes: "If we are to prevent the government from profiting from inflation, the tax code must be indexed."

Economic experts differ as to the efficacy of indexing and to what extent it is useful in ameliorating some of the effects of inflation. We asked economist Henry Hazlitt about the desirability of indexing tax brackets to protect people from the subtle plunder of bracket creep. While favoring indexing or its equivalent for income taxes, he points out: "If you index taxes, and then there is a demand to index so many other things — incomes, wages, *etc.* — that, I think, almost certainly tends to increase the inflation." This is so because it hides the impact and the politicians roll merrily along printing money to cover their Budget imbalances. Some economists think we can continue double-digit inflation by all-round indexing. Jim Sibbet, editor of *Let's Talk Silver & Gold*, explains why, in his opinion, this is a false hope:

"The reason why [*Brazil*] can do it is because they do not have the massive debt structure that we have. There is nothing to go bankrupt in Brazil. There is a small but growing middle class, a tiny wealthy upper class, and the bulk of the people are poor by their own standards. These wage-earners are not bothered by inflation very much because their wages are indexed to the Consumer Price Index. The middle class also uses indexation to protect their contracts. The wealthy have long since bought all the land and hedge against

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inflation by building and expanding plant facilities. The people that are hurt by inflation are the money lenders [*creditors and holders of bank accounts and money claims*] in Brazil. Those that do exist index their loans so they will not suffer. Also, there are few people living on a fixed pension.

"How different it is here in the U.S.A. where millions of people are dependent on a fixed pension. Millions more are money lenders. There is more wealth tied up in bonds and mortgages than in any other form. Another large segment of our wealth consists of savings and checking accounts. These, too, are a form of money lending. Never forget that the chief purpose of inflation is to tax money lenders [*such as savers*]. It just doesn't work that way in Brazil where there are so few money lenders" to be victimized.

In any case, indexing is not a fundamental solution, since it treats only the symptoms of inflation. As we have observed in these pages so many times, the core of the problem is inflation of the money supply by the Fed in order to fund federal deficits. If the Budget could be balanced and our monetary system reformed, indexing would be unnecessary. Nevertheless, tax-bracket indexing might be a useful stopgap. Without it, President Reagan's tax reductions will be eaten up as people are pushed into higher brackets by inflation. Mr. Reagan explained in his address to Congress on February eighteenth that tax indexing and other useful reforms are only being postponed for consideration until after his program for economic recovery has been enacted.

But inflation and bracket creep are certainly not the only subtle government hands picking our pockets. Virtually the whole of the federal income-tax structure rests on an insidious system known as withholding. Without this practice of deducting taxes incrementally from a worker's paycheck, the federal government could never hope to raise the huge levels of revenue taken from Middle America. If withholding were abolished, leaving the average American to pay his taxes in one lump sum, then people would fully realize how much they are being plundered and a full-scale tax revolt would ensue which would make the Boston Tea Party look like a prayer meeting.

Never mind that the withholding feature of the income tax requires employers to expend time, labor, and money in calculating, extracting, and sending to government the taxes imposed on employees. The employer is not compensated for this expenditure and is by law being forced to act as an unpaid tax collector for government. This is a clear violation of the Thirteenth Amendment to the Constitution, which prohibits involuntary servitude.

The essence of slavery is to be forced to work for another with no pay for doing so and under threat of force. That is what withholding taxes do to the employer. And the similarity to slavery goes well beyond forcing the employer to act as a tax collector. Congressman Philip Crane makes the point that during the Middle Ages a serf was required to surrender thirty percent of the fruits of his labor to the lord of the manor. Now that Americans are being taxed almost fifty percent of our incomes, observes Crane, we would have to *reduce* taxation substantially to reach the point where American workers are treated as fairly as the medieval serf! Of course our modern system is not called Feudalism but the Welfare State.

Few people now remember that the withholding of taxes from wages was instituted as a "victory tax" during World War II, and was supposed to last only for the duration of the war. As with so many of the New Deal programs, however, it is still around.

When the war was over, some did object to continuation of the withholding tax. In 1948, a small manufacturer in Westport, Connecticut, announced refusal to deduct the tax from her workers' pay. She was Vivien Kellems, a courageous lady who demanded that the federal government indict her for defying the withholding law so that the courts could be required to rule on its constitutionality. The government refused to do so — and, instead, seized the amount due from her bank account in violation of her Fourth Amendment rights. Miss Kellems sued in federal court to get her money back, and when the suit finally came to trial in February of 1951 the jury ordered the government to refund her money. Unfortunately, the question of constitutionality was never tested.

Because of its enormous vested interest in the withholding tax the federal government desperately avoids any test of its constitutionality. The stakes are simply too high.

Nonetheless, many have tried to fight the I.R.S. in the courts on the ground that I.R.S. procedures violate our constitutional rights under (say) the Fourth and Fifth Amendments. Usually they find that the federal courts are not interested in hearing arguments based on the U.S. Constitution. What sort of arguments? It's sadly ironic that cold-blooded killers have been let off by the courts on the technicality that the arresting officer failed to read them their rights, yet under our federal income-tax system millions of Americans are each year made to forfeit their Fifth Amendment rights when they fill out a 1040 form. Since the information given by the taxpayer in the tax forms can and will be used by the I.R.S. against him in court, the taxpayer is being made to act as a witness against himself.

But even if one could find judges determined to provide a strict interpretation of the clear meaning of the Constitution, few have the time and money to battle the armies of attorneys which the I.R.S. has at its disposal. When the I.R.S. goes to court on constitutional issues its life is on the line. It has long been I.R.S. policy to go from one court district to another until it finds a tame judge and gets the decision it wants. If it loses in a New York court over taxes relating to limited partnerships, for example, it might order agents in Atlanta to make it tough for taxpayers under that aspect of the law until someone challenges the I.R.S. in court on the issue. Such legal games are continued until the bureaucrats get the decision they want. Most taxpayers would rather pay what is demanded than risk the huge expense of lengthy litigations.

While we do not advocate tax striking, the fact that thousands of rank-and-file auto workers in Flint, Michigan, are rebelling against the tax system suggests that our country is ripe for rebellion against bureaucratic tyranny in general and the progressive income tax in particular. Many have come to the point of saying, "I'm mad as Hell — and I'm not gonna take it anymore!" The growing tax resistance movement is symptomatic of this terrible anger. While it is a risky matter for workers to stop paying their income taxes, the resisters reason that with so many of them doing it their protest might overload the system to the point where the I.R.S. cannot cope with the situation. After all, how can it send thirty-five hundred auto workers to prison?

Clearly, the I.R.S. and other federal bureaucrats are alarmed about what might happen if this tax protest spreads further. Which is why we are hearing a lot of news stories about I.R.S. convictions of tax strikers in the weeks surrounding the April filing deadline. The tax collectors warn all potential tax strikers of dire legal consequences. The I.R.S. has the whole force of government at its disposal and will certainly use it. If they want to get you, they have the power to do so. But I.R.S. knows that, even now, several million people are already refusing to file returns, and if this protest should spread dramatically there is little or nothing to stop it short of a police state.*

That's why, even though the I.R.S. has seven regional and fifty-eight district offices, along with twenty-six thousand agents and office auditors, most of its power results from psychological tactics involving as much bluff as is necessary to assure citizen compliance.

This is not to say that the I.R.S. won't use all its coercive powers to get your money if it thinks it is worth the time and effort; but harassment tactics are expensive, time consuming, and publically embarrassing to the I.R.S. It much prefers what it calls "voluntary compliance." To gain this the I.R.S. uses the threat of legal force to instill cooperation by a fearful public.

In his revealing book, *All You Need To Know About The I.R.S.*, (Random House, 1979), a former employee of the I.R.S. National Office, Paul N. Strassels, relates the following exchange from a Hearing of the House Ways and Means Committee:

"[*A*]t this hearing, then-Commissioner Donald Alexander was testifying, and at one point a congressman started in on him, saying in effect: 'Commissioner, how can you defend what we now know to be the established policies and regular practices of your agency, namely to wage a campaign of terror against the American people? How can you — the Commissioner of a major division of the U.S. government — defend the use of tactics that are carefully designed to threaten the American taxpayer, to keep him in a constant state of fear? This is a democracy [*sic*] we live in, Commissioner, need I remind you? And I would like to know how you can defend these tactics, this campaign detailed in our report?'

" 'Congressman,' I recall the Commissioner replying, quite calmly, 'I think you and I understand the realities of this world. The truth is that we have such a limited budget, such limited manpower to enforce the income-tax laws and collect the revenue, that the only way we can keep people in line, the only way we can keep them honest and paying their taxes is to keep them afraid.' "

This is done in a variety of ways. One is by means of the audit system,

*Leaders of the tax strike movement proclaim that five million Americans are refusing to pay taxes for ideological and constitutional reasons. That is simply not true. Most of these people wouldn't know the Constitution from their phone bill. They are part of the exploding underground economy and simply cannot survive financially if they pay taxes. Many will get away with it because the I.R.S. doesn't have the manpower to catch and convict them. But most of these people are earning only marginally taxable incomes anyway. If you think you can earn substantial income and not file a tax return you are playing I.R.S. roulette. It may take the plodding bureaucrats several years to get around to you, but the overwhelming odds are that they eventually will.

hanging like the sword of Damocles over every taxpayer — the honest and the dishonest alike. And, to obtain maximum impact, the I.R.S. picks its targets carefully. Former I.R.S. agent Strassels reports the following:

"The strategy also means that they go after some kinds of people who are more 'visible' than others, hence more useful. If they can cause problems for movie stars, sports heroes, and celebrities in general, the IRS knows the media will play it up, and their implicit warnings will spread widely. When I was in the IRS, I remember writing several interpretive memos on cases affecting Jack Benny, Groucho Marx, Olivia De Havilland, and Sugar Ray Robinson, all very complicated cases. And I recall Skitch Henderson's being sent to jail, and all the headlines that went with it.

"We joked about the best publicity the IRS could possibly receive: Put Johnny Carson through the wringer and have him tell a few scary, funny stories on late-night TV."

Other I.R.S. practices reportedly include the use of hit lists, electronic surveillance, confiscation of bank accounts without due process of court hearings, intimidation and harassment of tax preparers, and so on. For a chilling collection of horror stories, we recommend *To Harass Our People*, an excellent new book by Congressman George Hansen (R.-Idaho) and investigative journalist Larry Anderson. Published by Positive Publications, Box 23560, Washington, D.C. 20024, it is priced at $6.95.

Congressman Hansen knows a political issue when he sees it. So does Ronald Reagan, who has declared war on bureaucratic harassment of the people and promised to reduce government regulations and cut taxes significantly. Less than a month after entering office, President Reagan was moving on tax-rate reductions as an important part of his first set of legislative proposals.

On February eighteenth, when the new President revealed his Program for Economic Recovery to a joint session of Congress, some advocates of supply-side economics were disappointed with the Administration's tax-rate reductions. For one thing, the thirty percent cut (ten percent a year for three years) in personal income-tax rates advocated throughout the Presidential campaign is now slated to begin July first (Congress willing) rather than being retroactive to January first as originally promised. Seen as the result of pressures from traditional Conservatives in the Administration, this was evidently a way of trying to head off criticism that enactment of large tax cuts before substantial Budget cuts would increase the deficit and be highly inflationary. Even if the cuts in tax rates do go into effect July first, this justifiable criticism will continue. It means there are elements in the Administration which are not nearly as confident about the rate reductions as are Jack Kemp, Professor Arthur Laffer, and other supply-side advocates.

Although President Reagan did not mention it in his speech, a serious departure from Representative Kemp's expectations was the decision not to give individuals with taxable income above $42,500, and families with $60,000 in taxable income, the full thirty percent cut afforded others. The decision to limit tax relief for taxpayers in the upper tax brackets was intended to reduce political criticism of the program as a tax cut for the rich at the expense of the poor. It was also made to help hold down the loss of tax revenues, which many feared would enlarge the

deficit even further. But this has not prevented squeals of protest from those on the Left, who see the graduated income tax as serving egalitarian purposes. For example, Leon Shull, national director of Americans for Democratic Action, called Reagan's program "reactionary" and said it would cause "a massive transfer of income from workers, the middle class and the poor . . . to the wealthy and corporations in the form of regressive tax cuts."

This hysterical, irrational opposition from vocal Leftists makes the Reagan plan look good. And it is clear that such wailings would have been even greater had the President not limited his cuts on the high end of the income spectrum. But it was a serious mistake because the whole point of supply-side economics is to encourage investment in productive enterprise. Income not taxed from the wealthy is most likely to go to this purpose.

But, to spur industrial and business expansion, President Reagan also proposed a much more rapid depreciation allowance for plants, machinery, and business vehicles. He pointed out, and we certainly agree, that these changes are essential to encourage the new investment needed to create millions of new jobs and once again make America competitive in world markets. President Reagan claims that if passed intact his program would reduce unemployment to 7.2 percent by 1982, 6.6 percent by 1983, and 6.4 percent by 1984. He is even more optimistic about reducing inflation: down to 6.2 percent by 1983, 5.5 percent by 1984, and 4.7 percent by 1985.

Although the three-year plan for reducing tax rates will leave taxpayers about half a trillion dollars more in their pockets over the next five years, Mr. Reagan pointed out that the plan would not lower taxes below the current level, and that it is actually only a reduction in the tax increase which is already built into the system. In fact, Reagan's tax-rate reductions will be eaten up by the automatic increases in Social Security taxes already scheduled to take place during the next several years.

And Social Security by itself is a political time bomb. Unless something is done to increase revenues or decrease outlays, the Old Age and Survivors program will run out of cash benefits as early as 1982 or 1983. Obviously, the Reagan Administration will have to act soon to save the system from its cash-flow crisis. Either potential solution could be political suicide. If he lowers benefit levels to the elderly, terrible wrath will descend upon him from victims. But if Reagan increases F.I.C.A. taxes even more than their presently planned levels, this will nullify the positive economic effect of his tax-cutting promises, and probably lead to his rejection by Middle American workers. President Reagan is not in an enviable position under the best of circumstances.

Mr. Reagan proposes to save himself and the country with what George Bush used to call "voodoo economics" — the supply-side model. The application of supply-side economic theory to taxation is expressed in the now-famous Laffer Curve. Supply-sider Jack Kemp puts it in simple language in his book *An American Renaissance* (Harper & Row, 1979) as follows:

"The Laffer Curve restates the common-sense notion of diminishing returns. At some point, additional taxes so discourage the activity being taxed, such as working or investing, that they yield less revenue rather than more. There are, after all, two rates that yield the same amount of revenue: high tax rates on low production, or low tax rates on high production. A tax rate of 100 percent, for example, earns the same revenue as a zero tax rate — nothing — because in the first place no one would work, and in the second no taxes are collected in the income that is produced. There is, however, at any one time, some rate to allow the government maximum revenue and yet not discourage maximum production. It is the politician's job to find out what that rate is for the time and national circumstances."

All of this makes perfectly good sense, and it is likely that large cuts in tax rates would result in an expansion of the tax base, which in turn would bring in the same or even more revenues to government. The problem is the interim effect from deficit if government spending is not cut. And this important question remains: Why *should* our goal be the maximization of revenues to government, as Representative Kemp and others are clearly proposing? This assumption is challenged by those of us who are concerned that while the new supply-siders often speak about incentives and disincentives, they say too little about individual rights and the proper role of government. We believe there are limits to what government should be involved in — that its powers should be circumscribed by the principle of individual rights rather than being motivated by the amount of revenue it might be possible to squeeze from the people.

Even so, in an extremely important article which appeared in *The Review Of The News* for September 10, 1980, economist Hans Sennholz hails the many positive aspects of supply-side economics. Sennholz observes:

"With standards of living falling and unemployment rising, the supply-side economists are offering a major challenge to the Keynesian orthodoxy. They are emphasizing the importance of production, rather than consumption, urging immediate tax breaks for savers and business. They seek to encourage saving and investment to promote economic growth, to reduce the disincentive to work through lower tax rates, to stimulate business through accelerated depreciation and tax credits. In short, they are designing intriguing supply-side models that are manipulated to achieve the greatest increase in supply or G.N.P."

While giving the supply-siders their due approbation, however, Professor Sennholz goes on to express serious doubts about the application of supply-side theory to federal tax policies, and warns about how it might be misused:

"Most Conservatives are applauding the supply-side economists who promise new hope through tax reductions. But, despite all of the applause, this economist cannot escape the strong concern that some of these supply-side advocates want merely to substitute the collectivist Keynesian blueprint with their own, and replace the demand-side tinkerers in Washington with a new team of collectivist supply-side tinkerers.

"We must rejoice at the disrepute into which the Keynesian econometric models are falling. And we readily admit that the rise of supply-side economics, under certain conditions, affords new light and hope for a better economic future. But we cannot ignore some glaring problems that cast serious doubt on its efficacy."

Dr. Sennholz rightly emphasizes the point that, as far as the federal government is concerned, tax cuts do not necessarily reduce the burden of government. They do for state and local governments, perhaps, but these levels of government do not have the option of running Budget deficits and then funding those deficits through the creation of new fiat money. Sennholz elaborates:

"Given a continued high level of government spending, a tax cut merely shifts the burden to the two other sources of government revenue — to creditors who buy Treasury obligations, and to victims whose purchasing power is reduced through monetary inflation. Contrary to popular belief, it is the level of government spending that determines the cost of government. Taxation is just one form of government revenue which, in this age of deficit spending, covers merely a fraction of the total cost. A tax reduction, therefore, may be only a popular device for shifting costs to other victims."

No one denies that there will be a lag time between the tax cuts and income from the stimulus this gives the economy, which is in turn depended upon to fill the gap with increased tax revenues. In the meantime, everyone is agreed, there will be huge inflationary deficits that will (among other things) trigger expansion of all the income transfer programs which are indexed. Indeed, the politicians might go along with the tax cuts — then fail to follow through with sufficient Budget cuts, resulting in even larger deficits than expected under the Reagan plan. Although it now looks as if the tax-rate cuts might run into more trouble in Congress than the general Budget cuts, without heavy Budget cuts there will be a killer deficit that will make the Carter inflation look paltry by comparison. Will tax revenues under these circumstances really close the gap so that the Budget can be balanced?

In our opinion, what is needed first are monumental spending cuts — far in excess of those proposed. If as much as $350 billion were cut out of the Budget, we would still be spending only at the level of the Gerald Ford Administration. Sennholz recommends large cuts in government spending to go into effect simultaneously with the tax cuts, observing: "If government spending is maintained at previous levels, or even increased for any reason, the inevitable deficit would trigger an inflation the disastrous effects of which might far surpass the deleterious effects of unrelieved taxation." Then Professor Sennholz continues with this warning about the possible misuse of supply-side theory:

"And there is no doubt that government can promote economic expansion and development as readily as it has discouraged them during the last 50 years. It can devise controls and regulations, taxes and penalties, that hamper consumption. In fact, it is conceivable that government may use its powerful apparatus of coercion to promote saving and investing, industrial expansion and modernization. But such a policy, unfortunately, does not represent a return to individual freedom and free markets. It is radical interventionism that breeds more government power."

Rather than attempting to direct economic aggregates of spending or consumption through fascinating manipulations of tax rates, our leaders in government should be working to get government out of the way of producers and to reduce it to the point where eventually the graduated income tax can be eliminated entirely as a revenue device. Remember that America got along quite well for over a century without the Marxist income tax. It was a period of tremendous economic growth, few wars, and a constantly growing standard of living. In our opinion the collection by government of revenue should not be a mechanism for social and economic manipulation and planning by Left or Right. If tax cuts are good, it is because they allow individuals greater personal control over what they earn.

What impact the Reagan package would have on the economy is still a point of some uncertainty and disagreement even among Conservative economists. Long a staunch advocate of *laissez faire*, Henry Hazlitt expressed doubts about whether the proposed tax cuts would even create the promised economic expansion. "In fact," he told us, "I am very dubious about this particular tax-cut proposal. I do favor a tax cut, but it would mainly be a tax cut for corporations — more rapid depreciation allowances and lower corporate tax rates, and so on — but I don't think cuts in the tax on middle incomes would do anything particular to stimulate business."

Here we are back to the point that people with middle incomes are more likely to spend money from any tax reductions on consumer goods — like food and clothing — rather than put it into ventures where it would be available for capital investment and business expansion.

Hazlitt also expressed concern about such plans as Kemp-Roth locking the government into a commitment for tax cutting into the future: "I'm against the Kemp-Roth bill because I don't think it makes any sense to pledge to reduce taxes a year from now, or two years from now, because I don't think we know what the situation is going to be. Rather, we should leave ourselves open to make the decision that seems wisest at that time."

Another critic is the brilliant Free Market economist George Reisman, author of *Government Against The Economy* (Caroline House, Ottawa, Illinois, 1979). Professor Reisman doesn't think the Reagan package offers any solution at all to inflation. Dr. Reisman told us: "If the Reagan plan is going to result in either more spending or less taxes which enlarge the deficit, either they've got to print money faster or borrow more in competition with business. My guess is that the only way this program could work would be if they could freeze government spending — or sharply limit the rate of growth in it — and, at the same time, could let the private portion of the economy increase in its relative size. This would mean going through a period of higher inflation, but it might bring about an increase in production after the private part of the economy was increased relative to the government part. There would be bigger deficits and more inflation in the interval — and then the problem would be how they would get inflation back down from there."

The Reagan Administration nonetheless claims that its "voodoo economics" will balance the federal Budget by 1984. We asked Dr. Reisman if this goal can be achieved. He said he doesn't think the Budget will ever really be balanced because, even if the government could do so, it probably wouldn't for fear economic depression would result from the way our monetary system has been related to deficit spending. Professor Reisman, who says we have created a debt-oriented economy, explained:

"You have to realize that under the present monetary system the deficit is the main way by which the quantity of money increases. And if they really did away with the deficit, that would virtually stop the increase in the quantity of money. But the economic system is geared to a substantial increase in the quantity of money now — after all the decades of inflation we've had. We're hooked on inflation. Assuming for the moment that President Reagan should succeed in really doing away with deficits, and in slowing the increase in the money supply, given our present monetary system that would precipitate a major depression. This is simply because it would then be desirable to own dollars (whereas today it is not) in an economy that is geared to the undesirability of owning dollars.

"People are highly illiquid. There are massive debts that have been built up anticipating the continuation of inflation. If these expectations are going to be disappointed, and people are going to want to hold dollars, then the implication is a major contraction in spending.

"So the great problem is how to reduce the expansion of the quantity of money without having enormous withdrawal symptoms. Even if the tax cuts were to stimulate production, the problem is that, with the increases in the money supply we have had, the velocity of circulation of money is at a level, I think, that can only be sustained for a time by continued rapid inflation. The costs of slowing down would be drastic. That's why I think that when inflations get to this level they're not going to be stopped."

In other words, because federal deficits are paid for by either inflation of the money supply by the Federal Reserve (which pushes up general prices), or by the government borrowing in competition with business (which pushes up interest rates and starves the private sector of capital), any true solution to the problem of inflation must include some way to separate our monetary system from the fiscal policies of government — in such a way as to avoid or minimize the adjustments in allocations that could produce the economic panic. This is why — as we stressed in our article on Reaganomics in the January issue — we must abolish the Federal Reserve central banking system and establish a true gold standard.

Dr. Reisman points out that even most of the advocates of a gold standard have not addressed the problem of how to avoid a painful (and politically suicidal) depression in the transition to a sound money economy. A student of the economist Ludwig von Mises (who served on the Editorial Advisory Committee of AMERICAN OPINION until he died in 1973), Dr. Reisman has given considerable thought to this particular problem, and he discussed it in principle in a speech at the Inflation And Gold Seminar held in Chicago on May 25, 1980.

In that talk, entitled "Gold: The Solution To Our Monetary Dilemma," Professor Reisman outlined how our economy has become geared to continued inflation and how this process has set the stage for economic bust if the expansion of the money supply is dramatically terminated. In his view, the critical factor involved is how to avoid a contraction of spending and revenues in the private sector following the cessation of inflation — a contraction which would otherwise leave millions of people with no means of paying debts incurred on the presumption of perpetual inflation. He argues convincingly that this could be accomplished by the adoption of a 100 percent reserve gold coin system *at an appropriately high price for gold*. That is, it would be possible "to stop inflation cold with 100% gold money, and simultaneously offset the fall in the velocity of circulation of money by making the gold supply equal to enough dollars to leave spending in terms of dollars unchanged."

To bring this about, the government would take its present gold stock of 265 million ounces (assuming it still has the gold) and price it high enough to make it more than equal to the prevailing money supply. Dr. Reisman estimates that a price for gold of about $2,500 an ounce would be sufficient. The government would call in all paper currency and exchange newly minted gold coins for Federal Reserve notes. The rest of the gold would be used to place our banks on a 100 percent reserve basis against their checking deposits.

Professor Reisman reasons that since people would hold their new gold coin money very tightly, the velocity of circulation would be relatively low, but a $2,500 price for gold would compensate for the contraction in *dollar* spending that would otherwise result. And it should be pointed out that, while gold would be the main element in Reisman's program, silver coins would also have to play a significant role alongside gold.

The transition to a 100 percent reserve gold coin money as advocated by Professor Reisman would permanently end both inflation and deflation, and could do so without producing a severe depression. Professor Reisman asserts that "if we could solve our monetary dilemma in the way I have explained — by ending inflation in an environment of great financial liquidity, that is, of large holdings of gold money relative to spending — we could also radically reduce the size of the government's budget, the scope of government activity, without fear of causing mass unemployment or a depression . . . . If firms possessed large cash reserves and smaller debts relative to their revenues and incomes, they would be able to ride out the kind of temporary, localized failures of demand that would accompany slashing the government's budget."

We will discuss Budget slashing next month. In this context, it is sufficient to note that much more could be cut from federal spending. Even so, as Dr. Reisman admits, such a reform is not likely to be adopted given today's political realities. It is possible, however, that in the future there might be sufficient support for such fundamental change.

More likely, America will not return to gold and silver money as a formal policy of government — at least, not in time to prevent the collapse of the dollar through hyperinflation. In the absence of a balanced Budget, as inflation builds, we may very well see people turning to gold and silver coins, naturally, on their own, to escape the ever-inflating dollar economy. Barter and the use of silver and gold money could develop into a full-fledged alternative economy — an "underground economy" — separate from dollar-denominated exchanges which suffer the ravages of inflation and taxation.

But, as Joe Louis used to say, you can run but you can't hide. As good as long-term investments in gold and silver coins are when used as chaos and inflation hedges, even accumulation of a substantial supply won't isolate you from all the terrible effects of a collapsing dollar economy and its social consequences. That's why the solution here involves a great deal more than just saving one's own financial skin. Running off to the hills with your survival food and gold won't help you at all if amid economic chaos our government goes completely totalitarian.

After giving a series of lectures on Free Market economics in Argentina, Professor Percy Greaves, another disciple of the great Ludwig von Mises, was asked what investments he would recommend to save one's wealth in the long run. Part of his reply is as follows:

"If you find a way to profit from this inflation, or even to save what wealth you have, you can be sure you will be considered a public enemy by all the suffering people around you. If you have wealth while those around you are starving, your life will not be worth much. It will not be worth any more than the lives of the Jews in Germany during the final days of Hitler . . . .

"The problem is one of saving the system. We are all in it together. It is as though we were all out in a lifeboat in the middle of the ocean. If the boat goes down, being the richest man in the lifeboat will not save your life. It will not do you any good to own great wealth if the society is not saved. If one of you, or a few of you, could own or get title to all of Buenos Aires, it would be worthless to you without the co-operation of your fellow men. The lights would go out. The gasoline pumps would not work. Your physical wealth would be completely without value without the social co-operation of your fellow men. It is the free market society that must be saved."

That is a summary as wise as it is powerful. ■ ■

Answer to Right-Acrostic on Page 55

O. WILDE: IMPRESSIONS OF AMERICA

"The Americans are the best politically educated people in the world. It is well worth one's while to go to a country which can teach us the beauty of the word FREEDOM and the value of the thing LIBERTY."

A. Owly
B. Wrath
C. Inundated
D. Let the
E. Daffodil
F. Eeyore
G. Iterated
H. Michael
I. Photo
J. Rennet
K. Each to
L. Stewer
M. Scythe
N. Iolanthe
O. Other
P. Nob Hill
Q. Switch
R. Ought
S. Fugue
T. A will
U. Moppet
V. Ebbeth
W. Rawly
X. Icarus
Y. Coveted
Z. Atchison