INTRODUCTORY MACROECONOMICS 1982-83

Readings on Contemporary Issues

EDITED BY
PETER D. McCLELLAND

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FOREWORD

To the student

When you signed up for a course entitled Macroeconomics, you probably had two expectations. The first was that you were about to study many of the problems featured in the national news media. Inflation, unemployment, federal deficits, the inadequacies of our present welfare system—these are but a few of the macroeconomic issues encountered almost daily as you read the newspaper or watch the evening news on television. Probably your second expectation, fostered by the same sources, was that your studies would help you to understand why economists have sharply differing opinions on how these problems should be attacked. If your course reading were confined to a textbook—any textbook—you would be in for a disappointment. These books invariably include little about contemporary problems, and even less about the national debate on how to solve them. The reasons are rather simple. Each author has his or her own opinion on the ideal solutions, and each text, not surprisingly, tends to emphasize that point of view. As for contemporary issues, no textbook that appears today (never mind last year) can possibly deal with them, because the lag between finished manuscript and appearance in the bookstore is usually twelve to eighteen months, or even longer.

This reader's main objective is to remedy these two defects. Assembled in early June, it attempts to give empirical flesh to those theoretical skeletons you will be learning about in lectures and from the textbook. It also emphasizes, wherever possible, different points of view on how to solve some of our most pressing macroeconomic problems. It cannot promise you a definitive resolution of those problems. But it should give you a sense of why they matter and why macroeconomic theory is relevant in attempting to solve them. The ultimate hope is that you will emerge from this reader and your course with a sense of how crucial these issues are to the future well-being of our nation and its citizens.

To the instructor

Teaching macroeconomics to undergraduates is a demanding assignment. The lecturer who strives to integrate textbook theory with national problems is constantly bedeviled by the speed with which the leading contemporary issues change—from unemployment to energy to inflation and then back to unemployment again, to mention but one of several recent sequences. Also in a constant state of flux are the mechanisms that dominate current analysis of these problems. The unabashed Keynesian approach tempered by a belief in the Phillips Curve has given way to such disparate topics as rational expectations, supply-side economics, and the merits of monetary targets. In the popular press, there is no shortage of commentary on both problems and associated causal mechanisms. The difficulty is that several dozen articles from different sources cannot be incorporated easily (or at all) into the reading list of a course in which enrollment may run to hundreds—at least not without creating pandemonium in the library. This book attempts to resolve this impasse. Readings were culled from a range of material in May, assembled in early June, and made available in bound form by mid-August. The result is viewed by both the editor and Cornell University Press as part of an ongoing project. We update this volume annually, in terms of both topics covered and articles included. We hope that you will help us with that updating process. If you have any suggestions, I would appreciate hearing from you (Economics Department, Cornell University, Ithaca, N.Y. 14853). Such interaction with those who study and teach the subject will be a crucial ingredient if this annual reader is to satisfy the instructor while achieving that most important of objectives: fostering the student's interest in, and understanding of, contemporary American macroeconomic issues.

Peter D. McClelland

Ithaca, New York

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How Businessmen Became So Disillusioned

Speaking of Business

by Lindley H. Clark Jr.

American businessmen supposedly elected "their" President in 1980. Ronald Reagan, after all, stood for all those things for which businessmen yearn: limited government, low taxes, balanced budgets. After almost a half-century in the wilderness, businessmen were to be led into the promised land.

So why aren't businessmen happy?

In the past few days, business groups have attacked the President for budget plans that promise deficits far into the future. Administration officials resort to rhetoric that makes deficits sound like at least necessary evils if not developments to be desired.

Business leaders, few of whom could be called soft on communism, indicate a somewhat slower defense buildup would be fine with them. After all, we're not going to be able to blow up the Russians if we first blow up our own economy.

Business groups agree with Mr. Reagan that more spending cuts are needed elsewhere, and here Congress has most of the responsibility. But they also think that the government, like it or not, is going to have to do something to push up tax revenues in the next few years. Administration officials poke fun at the businessmen because they can't agree on what taxes should rise. That's buck-passing of the worst sort; government, not business, enacts tax changes. If there is worry about whose ox is to be gored, a slight increase in all taxes might be the answer.

The country needs to have some hope that budget deficits eventually will come down. The decline that is portrayed in the new budget for the fiscal year starting Oct. 1 is largely phony. It rests on assumptions that Congress will pass several tax changes, such as withholding on interest and dividends, that the lawmakers have rejected several times before. It rests, also, on some highly optimistic forecasts of economic growth in the next three years.

Part of the damage the deficits do is purely psychological. Perhaps nothing terrible will happen but it might, and as long as the possibility persists it worries businessmen and investors and discourages activity.

The primary real danger of the deficits is that they put pressure on the Federal Reserve System. Nowhere is it written that the central bank cannot allow a Treasury securities offering to fail, but central bankers have always assumed it to be so. The larger the deficits, the larger the issues of new Treasury securities. As long as the Fed can sell the new securities to private investors, and private investors continue to hold them, there is no immediate danger. But if the Treasury wants to sell, say, 10-year bonds and the market is already flooded with 10-year Treasury bonds, the issue can be sold only if the Treasury will accept a sharply lower price and a sharply higher interest rate. There will be pressure on the central bank to bail out the Treasury by buying bonds.

When the Treasury adds to its bond portfolio, for this or any other reason, it pays for its purchases by crediting the reserve account of the bond-seller's bank. By adding to bank reserves, the Fed makes it possible for the banks to acquire additional deposits by making loans and investments, thus boosting the money supply. That's the way federal debt is turned into money, a process that can prove to be highly inflationary.

Even if the Federal Reserve manages to avoid monetizing debt, the nation is by no means out of the woods. The Treasury and private business draw from exactly the same pool of savings. The Treasury, obviously enough, will get what it wants whatever the interest rate, and businessmen will have to settle for what's left, whatever the interest rate. Large and growing federal deficits threaten to bring about still higher interest rates together with even more sluggish economic growth.

There's no way to know just how this latest business vs. government confrontation will work out. Right now there seems to be more sadness than anger on both sides. The Reagan administration can't understand why businessmen don't realize that the administration has their best interests very much at heart. And businessmen can't understand why all those glittering promises of 1981 have gone dim amid the realities of 1982.

It doesn't help a whole lot to have the administration brag about the decline in the inflation rate. That's a real achievement, but it's of limited usefulness. The big budget deficits make businessmen worry that the progress the Reagan team has made against inflation is only temporary, soon to be reversed.

The Reagan administration claimed that it offered the nation a new economic stability. That was a purpose of the three-year schedule of tax cuts, an arrangement to enable people to plan their financial future for years ahead. But the economy instead has been hit by an increase in instability.

Lawrence Chimerine, president of Chase Econometric Associates, a consulting affiliate of Chase Manhattan Bank, has an idea how this will all come out: compromise.

"Unless significant adjustments are made," he says, "the deficits in the years ahead will be the largest in our history, even relative to the gross national product, and will rise each year. . . .

"We continue to believe that a compromise will be reached later this year which will provide for significant adjustment to the current policy mix. This reflects our view that the administration strategy is aimed at achieving the minimum level of social program expenditures and the maximum military buildup that are politically possible, in addition to producing a stronger economy and a favorable outcome in the November elections.

"In order to achieve these goals, the administration budget includes far more social program cuts than they (the Reagan people) expect will be enacted; incorporates a significantly larger military buildup than they will accept; and includes more tax cuts than are compatible with the military buildup and modest federal deficits."

Mr. Chimerine expects sharp cuts in social programs and military spending, cancellation of the 1983 installment of the personal tax cut, and a step-up in money supply growth—in other words, the Chase Econometrics president looks for compromise all around.

In the current disillusionment, Mr. Chimerine's scenario could prove to be right. Mr. Reagan's error was not in trying to do too much. His mistake was in seeming to say that he could do it all at once and at a small price. Businessmen and other Americans have been very surprised by the sheer magnitude of the actual price and, in the event, they may be unwilling to pay it.

2

Liberal economists await the pendulum's swing

Counting on Reagan to fail because of his tax approach and monetary restraint

President Reagan's election and the strong mandate he received to try something new in economics are in great measure the result of the failure of liberal economics to deliver on its promises. Although liberals may well blame the political ineptness of the Carter Administration for part of the failure, it seems clear that the U. S. public was tired of the 40-year domination of J. M. Keynes and the liberal Keynesians over economic policy. It was ready for the conservative, free-market approach that Reagan has taken in the last six months.

But liberal economists regard their exile as temporary. "I do not think the basic liberal agenda is dead," says Alan Blinder of Princeton University. "It will make a comeback when the polity makes a swing back to us."

Most liberals believe that such a swing will occur, even before Reagan's first term expires, because they do not think the President's economic program will work. For one thing, they argue that Reagan's broad-based tax approach fails to attack the structural problems of the economy and its ailing industrial base and may even worsen regional and sectoral disparities. The Reagan program, liberals contend, does not address the problem of the movement of companies, jobs, and people out of the industrial heartland, leaving in its wake a deteriorating tax base and states and cities on the verge of bankruptcy.

For another, they believe that Reagan's heavy reliance on monetary restraint to fight inflation raises the risk of pitching the U. S. into a serious recession that could fuel the kind of social disruption associated with "Thatcherism" in Britain. As they see it, Reagan's combination of tight money and stimulative tax cuts makes a collision between monetary and fiscal policies inevitable. At best, they see the current experiment in monetarism condemning the U. S. to high interest rates, sluggish investment, and slow growth for years to come.

At the same time, the liberals are painfully aware that right now they do not have a clear-cut systematic alternative to Reagan's program. Liberals agree that their thinking on a host of issues, while not bankrupt as some critics claim, got out of touch with reality during the 12 years in the last 20 when Democrats called the tune in Washington. Although liberal economists, almost by definition, are still committed to using government programs to fight unemployment, poverty, and inequality, they also recognize that they and the Democratic policymakers they advised relied too heavily on big government to wage the battle. "Bureaucracy was allowed to run a little wild during the Great Society days of Lyndon Johnson," says Robert Solow of Massachusetts Institute of Technology. "Today's revolt against regulation is justified."

With these past failings in mind, liberals have begun to reexamine their old ideas and seek new approaches:

REINDUSTRIALIZATION. Liberal economists are sharply divided on how far government should go in intervening in the private sector to revitalize U. S. industry, but Gar Alperovitz of the National Center for Economic Alternatives in Washington warns that the U. S. economy is headed for disaster in the 1980s if government, business, and labor do not start planning together soon to deal with its structural problems.

Alperovitz would "use public investment in the infrastructure—the bridges, ports, railroads that industry needs—as a locomotive to get the economy moving. Then we must target key sectors of the economy for aid, using a new Reconstruction Finance Corp. to build toward a comprehensive growth and anti-inflation strategy." Taking a somewhat different tack, Lester C. Thurow of MIT notes in his controversial book, *The Zero-Sum Society*: "We do not need central economic planning in the sense of an agency that tries to make all economic decisions, but we do need the national equivalent of a corporate investment committee to redirect investment flows from our 'sunset' industries to our 'sunrise' industries." Thurow also urges creation of a National Investment Bank and elimination of the corporate income tax to spur capital spending and greater government aid for research and development to encourage innovation.

INFLATION POLICIES. Keynes was more concerned about inflation than most of his followers, but the postwar generation of Keynesians who provided the basis for today's liberal thought could not shake the idea that unemployment was always the biggest economic issue. They blithely analyzed away the inflation problem in the 1960s with the Phillips Curve concept, which held that there was a neat long-term trade-off between inflation and unemployment, allowing policymakers to pick any politically acceptable combination through fiscal and monetary fine-tuning. The combined high unemployment and inflation rates of recent years throughout the industrial world have shattered the trade-off idea. In *Prices and Quantities: A Macroeconomic Analysis*, the late Arthur M. Okun of the Brookings Institution wrote: "The plain fact is that no school of economists has a satisfactory theory of inflation."

The liberals now accept the idea that excess growth of the money supply is part of the inflationary process but reject the monetarist claim that it is the sole cause. Instead, they cling to Keynes's explanation that inflation is essentially wage-based (compounded by such supply shocks as OPEC oil price increases). Okun's book suggests that long-term arrangements between management and labor and among companies act as an "invisible handshake" that keeps wages and prices rising even when the overall economy weakens. Thus, Okun and most other liberals wind up recommending some form of incomes policy to supplement restraint on demand in fighting inflation. The most popular liberal suggestion is a tax-based incomes policy [TIP] that would use tax penalties or rewards to encourage wage and price moderation. But Barry Bosworth of Brookings warns: "The next liberal to prescribe an incomes policy had better specify why his version will work when everything else failed in the past." One fresh approach being considered by liberals: Attack wage-push inflation by forcing unions to move to one-year contracts from the currently typical three-year pacts in order to break the momentum of the wage-price spiral.

MANAGING THE ECONOMY. The belief in fine-tuning was raised to the level of mythology in the early 1960s, when the "new economists" of the Kennedy and Johnson Administrations used a skillful blend of fiscal and monetary policies to sustain high growth and low inflation rates. The tax cuts they fashioned as incentives for investment are a model for today's supply-siders. But the Vietnam war and the resultant inflationary explosion blew away the "new economics," along with a lot of other dreams.

James Tobin of Yale University, who was a member of Kennedy's Council of Economic Advisers, admits that he and the other new economists overpromised. "We let the public think the system could provide full employment and price stability all the time, if we just left everything to Walter [Walter W. Heller, CEA chairman from 1961 to 1964]," he says.

Liberal economists have no systematic alternative to the Reagan program

Today, Tobin and other liberals still believe in combining fiscal and monetary policies to manage aggregate demand but would put more of the load on the fiscal side by cutting taxes less than Reagan proposes and targeting the reductions more narrowly to investment. They would still try to restrain the growth of the money supply but would put more emphasis on managing interest rates, dropping what Tobin calls "the monetarist obsession with money numbers." Like conservative economists, they would wring out inflation gradually by restraining the growth of the nominal gross national product.

The liberals' reluctance to slash taxes as sharply as Reagan proposes stems partly from their desire to avoid drastic spending reductions in Social Security and other social programs. But they also argue that the best way to spur savings and reduce inflation is to move the budget into surplus and retire federal debt, even if that means allowing taxes to keep rising.

However, liberals say they do not want to return to the free-spending ways that helped create today's economic mess. Bosworth notes that Reagan's fight to restrain the budget's growth may finally give government "a basis for saying 'No'" to the rival constituency demands that spur federal spending.

INCOME DISTRIBUTION. "The question of distribution involves a bedrock value judgment for liberals," says Blinder of Princeton, "though we may disagree over just how much society should do for people who can't do for themselves." Thurow takes an even sterner view: "There is a political limit to the extent to which people are willing to see their money go for helping economic misfits. The growth of income transfers through the government has left both the givers and the recipients feeling angry and ripped off."

Liberals insist that the social and job programs created in the 1960s and greatly expanded by former Presidents Nixon, Ford, and Carter were meant to equalize opportunity rather than income but that most were poorly planned. "In designing our programs, or rather leaving the design to bureaucrats, we liberal economists glossed over the need for incentives for people to improve themselves," says Sar Levitan of George Washington University. Indeed, adds Nancy Barrett of American University, "by putting high marginal tax rates on work effort, our programs built in disincentives for the poor to get into the labor force." Now, liberals are looking for ways to encourage the marketplace itself to reduce income disparities.

On distribution as on other issues, liberal economists have not given up on government activism but are moving toward a pragmatism that would apply Washington's power on a case-by-case basis. "We can favor more environmental regulation and less in trucking without having to decide the issue of more or less government," says Nobel laureate Kenneth Arrow of Stanford University.

Moreover, a growing number of liberals have turned almost as strongly in favor of deregulation as Reagan's economists. A few even propose abolishing the antitrust laws on the ground that they are tying the hands of U. S. companies in international competition, especially against the Japanese.

This "eclectic pragmatism," says Tobin, is what liberals must try to provide for the U. S. if the political pendulum swings their way again. "It does not have the sales appeal of Reagan's economic approach. But there will be a time when the public will want a less ideological brand of economics." ■

3

The postponed depression

Reaganomics continues a process that Roosevelt's New Deal interrupted

Sidney Lens

President Reagan's severest critics, no less than his most ardent admirers, like to depict his Administration's economic program as a dramatic departure from past policy. It isn't, though; it is merely the second phase of a Government-managed reduction in American living standards that was begun under Reagan's Democratic predecessor, Jimmy Carter.

Under the "voluntary" wage guidelines applied during the last two years of the Carter Administration, wages lagged 5 or 6 per cent a year behind increases in the cost of living. It was a first in American history: Never before had a President proclaimed it to be national policy to reduce workers' real income. Washington's intense pressure made it a virtual act of treason for unions to seek wage increases that would just keep pace with the cost-of-living index.

The "voluntary" guidelines are gone, but the Reagan Administration is continuing the Carter policy by other means. Chrysler workers were compelled to give up forty-six cents of their hourly pay as a condition for Federal loan guarantees to keep the big corporation afloat. Union "give-backs" are, in fact, rapidly becoming a national disease; Ford exacted an even larger give-back than Chrysler from its steel workers, and many other corporations are following suit.

Furthermore, Reagan is expected to set a pattern for about fifteen million Government workers by granting only a substandard wage increase to Federal employes. The Federal pay raise, 9.1 per cent last year, is expected to run 5.5 per cent or less, and pensions and other benefits will also be adversely recomputed. All of this will certainly affect state and local government employes, and ultimately the entire economy.

The new dimension Reagan has added to the Carter program is a savage attack on the poor. This was implicit in Carter's policy—there was talk, for instance, of changing the formula for adjusting Social Security for inflation—but Reagan has made it explicit and blatant. Hundreds of programs that have provided some relief to the poor for several decades are being scuttled. Reagan knows his proposed rollbacks will not be fully enacted, but like a good collective bargainer he puts forth so many demands that even passage of only part of the package will represent a major victory. After a few months of Budget Director David Stockman's relentless barrage, many Americans will feel relieved if only 80 per cent of the Administration's take-aways win Congressional approval.

Though the Reagan program threatens a substantial number of interest groups with a loss of benefits, they have been unable, so far, to mount a united resistance to the total program. The attack came too swiftly; it disarmed opponents, leaving each group scrambling to save itself—if need be, at the expense of others. Dairy farmers, for example, insist on retaining their subsidies, but are quite willing to endorse cuts in benefits for organized labor and consumers. The Senate's best known critic of Government waste, William Proxmire of Wisconsin, told a television audience he would favor even larger budget cuts than those Reagan proposed, but a few weeks later told another interviewer that he favors more subsidies for his state's dairy industry. Such divisiveness enables the Administration to dispatch its critics one at a time.

If Reagan can win a substantial victory against the defenseless poor in these first months in office—during the usual "honeymoon" accorded a new President—his next target is likely to be the labor movement. If the Government intends to continue cutting living standards, it must weaken the most highly organized force, the unions, so that they will offer no resistance. Ultimately, the Government may try to dilute or even abolish true collective bargaining by having official commissions make the final decisions on wages and working conditions. Much sooner, though, we may see attempts to impose severe restraints on the right to strike, and perhaps to abolish it entirely in the major industries.

Given the present condition of American capitalism, such draconian measures are necessary if the system is to survive. The Government *must* continue to reduce living standards, for three fundamental reasons:

First, the United States is losing its competitive edge. Japan, Germany, and a number of smaller industrial

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states have become more efficient in many key industries. Japan now surpasses the United States in the production of steel and automobiles. (The Soviet Union surpassed the United States in steel years ago.) In per capita gross national product, the United States is now tenth in the world, behind most Western industrial nations. Productivity, which rose by 3 per cent a year in the 1950s, has been declining by 1 per cent a year since mid-1977. A majority of America's best scientists and engineers are involved in military production, leaving the private sector starved for new ideas. And our corporations would rather buy up existing firms—as Standard Oil of Ohio recently bought Kennecott Copper—than invest in better technology.

Second, the terms of trade—the relationship of prices for American goods to those of developing countries—are no longer favorable. For more than a century, the terms of trade have been a means of draining wealth *from* the colonial nations and spheres of influence *to* London, Paris, Berlin, Washington, Tokyo. But since the Yom Kippur war of 1973, the terms of trade in at least one key commodity—petroleum—have turned sharply against the West. Prices for oil have gone up far more rapidly than prices for U.S. goods, and the result is that many millions of dollars are flowing *out* of the United States into the bank accounts of Saudi Arabia, Nigeria, Iraq, and Venezuela, instead of flowing the other way.

Third, the foreign policy defeats the United States has sustained in Vietnam and elsewhere have encouraged the oil producers and other Third World nations to stand up to American pressures. Should the United States suffer further foreign policy setbacks—as it almost certainly will—the effect on our economy will be extremely adverse.

Unfortunately, the Third World, except for the oil countries, is also in desperate straits. International debts have piled up to an incredible $500 billion, and some countries are bankrupt (Zaire) or on the brink of bankruptcy (Brazil). Such countries are kept afloat by additional loans from the International Monetary Fund or private Western banks, or both—but only on condition that they impose severe austerity on their people. Wages must not be raised, new social programs must be curtailed, and other sacrifices must be demanded of people living on the edge of subsistence.

The result is that we are likely to confront "second" revolutions in dozens of countries that made their first revolutions for national independence in the quarter of a century after World War II. If the United States responds to these second revolutions in the same heavy-handed way it handled Vietnam or is now handling El Salvador, we are certain to see further reverses for American foreign policy—and a further need for economic retrenchment at home.

What the Reagan Administration is attempting to do to the American economy, therefore, is not a product of sheer malice or incompetence, but a response, however inept, to the condition of our capitalist society. The system is in a *permanent* crisis that can no longer be mitigated through Keynesian ministrations. We confront, once again, the old question of markets.

Since World War II, the domestic market has primarily been sustained by $2.3 trillion in military spending. These expenditures have provided an artificial and tenuous prosperity dependent on an increasing level of debt, since militarism produces neither consumer nor capital goods to generate further economic activity. Federal debt grew by $400 billion from 1970 to 1978 alone, and now requires annual interest payments of $90 billion.

This process can go only so far without bankrupting the economy. That is why both the Carter and Reagan Administrations have emphasized the need to reduce Government spending and balance the budget. But they have been caught in a bind from which there is no escape under present rules of the game: Militarism is the crutch that supports the economy, as well as a significant cause of inflation.

In the 1930s, the Government was able to revive a stagnant economy by providing purchasing power and capital—without bankrupting itself. Given today's staggering national debt, however, "compensatory spending" can only cause more inflation and threaten economic collapse. That is why the Reagan Administration's tax cut is scheduled to go primarily to the rich; the assumption is that the rich will not spend their tax savings but invest them in industry and technology.

Such "supply-side" economics are no more effective than "demand-side" economics in significantly increasing the purchasing power of most Americans. Consumer debt has tripled—from $400 billion to almost $1.2 trillion—in the decade from 1969 through 1978, and real wages have been declining since the mid-1970s. Supplying more goods in a contracting market makes no more sense than boosting purchasing power when supply is stagnant.

What we have is the classic formula for an enduring depression. The major difference between the 1980s and the 1930s is that the current downturn is being "managed"—living standards are being manipulated to drop in an "orderly" fashion rather than in a free fall.

Compounding the problem of a contracting domestic market is international competition. While American industrial capacity has grown phenomenally since World War II, so has that of our German and Japanese competitors, who are now taking markets away from the United States. In the 1960s, for example, the United States and Germany each controlled one-third of world exports in metal-working machinery; in the 1970s Germany's share jumped to 40 per cent, while the U.S. stake fell to 21 per cent. In all, the United States lost 16 per cent of its share of world markets in the 1960s and another 23 per cent in the 1970s. Still, Germany's economy is currently also in a slump, and one that seems likely to endure—especially if conditions in the United States remain depressed. The United States is no longer the kind of prop to the world economy it was after World Wars I and II; it is in disarray itself.

The current crisis can best be understood in the context of the Great Depression of the 1930s, when American capitalism was on the brink of extinction. Franklin D. Roosevelt's New Deal saved the system by establishing two welfare states—one for the poor and one for the rich. Roosevelt boasted, quite accurately, that he saved America from revolution; without the welfare state for the poor—welfare, Social Security, unemployment compensation, and similar benefits—the strikes and demonstrations of the 1930s would have culminated in revolt. And without the welfare state for the rich—subsidies and Government loans to business, tax breaks, accelerated depreciation, and the like—capitalism would have collapsed.

But the New Deal provided no cure for the Great Depression. The rate of unemployment, 25 per cent in 1933, fell only minimally, to 20 per cent, by 1939. Roosevelt gave America hope, but his program did not solve its problems. On the contrary, what had begun as an internal economic crisis evolved into a worldwide military crisis. The developed nations fought each other for markets, manipulating the value of money, raising tariffs, entering into bilateral trade pacts, engaging in territorial aggrandizement. In 1939, they went to war—a war that ultimately cost fifty-two million lives and a couple of trillion dollars in wealth.

The United States emerged from that war in far better condition than any other nation. It had doubled the capacity of its heavy industry. All it needed was markets, and it gained those markets by giving about $200 billion in economic and military aid to nations willing to join the "American system." In return, those nations had to accept the American dollar as the international medium of exchange and agree to "free" trade and investment—guaranteeing that the United States could penetrate their markets.

The quid pro quo was the U.S. expenditure of more than $2 trillion on a military machine to protect those countries and leaders who joined the American system, and to ward off those who challenged it—most notably the Soviet Union. It was this vast commitment to military spending that created a full-employment economy from 1946 to 1971, but it also eventually undid the American prosperity.

In 1971, the delicate mechanism began to fall apart. America's balance of payments turned severely adverse. President Richard Nixon was forced to impose controls on wages and prices and to take the United States off the gold standard. The dollar fell in value as the price of gold soared from $35 an ounce to as much as $800 (it is now near the $500 mark). All this instability reflects the burden of a staggering indebtedness. Government debt has risen from $25 billion in the early Roosevelt years to $975 billion today, and the United States has an additional $800 billion floating around the world, backed by nothing more than a *promise* of redemption.

The comforts and conveniences of American prosperity have been bought at the expense of our children, grandchildren, and great-grandchildren who will have to pay for them for many generations—but there is a limit to such speculations. That limit was reached a decade ago, though we have only recently become acutely aware of the fact. Obviously, the Reagan program, with its traditional "trickle-down" notion, offers no solution.

What ails the American economy is not something episodic or ephemeral, but something basic. The Great Depression of the 1930s was not cured; it was merely postponed. We bought a reprieve for a few decades through war and ever increasing military expenditures, but now the sidetracked depression is back on the main track and moving full-steam ahead.

Reagan's desperate gamble is to try to save the economy—or at least buy more time for it—by dismantling the welfare state for the poor while preserving the welfare state for the rich. The American economy can no longer support *both* welfare states: One has to go. And democratic rights are likely to go with it, for it is inconceivable that tens of millions of people will give up benefits they have won over a half century without fighting back, and it is equally inconceivable that a government of the privileged few will not meet such resistance with police-state measures. Nixon had such plans worked out in detail; they were derailed by Watergate. Reagan's team probably has similar, and even more oppressive, plans.

For the Left, Reaganomics offers both a threat and an opportunity. The threat is one of economic hardship and political repression. The opportunity is one of proving to the American people that "free enterprise," even when propped up by militarism, doesn't work. If the Left can see its role in broad perspective, it will win this fight. The biggest danger it faces lies in narrow vision, in concentration on a host of limited goals to the exclusion of the ultimate goal.

Certainly we must continue struggling for jobs, welfare benefits, health care, for closing down nuclear reactors, for reducing military spending. But the Left must also give America a vision of a better tomorrow. The fight for jobs and peace will inspire Americans only if it is coupled to a program for democratic socialism—for economic planning, for social ownership of certain basic industries and social control of others, for extensive welfare measures, and above all for decentralized popular control of both government and the economy.

The alternative is a Reaganite form of the corporate state—a prologue, perhaps, to fascism. ■

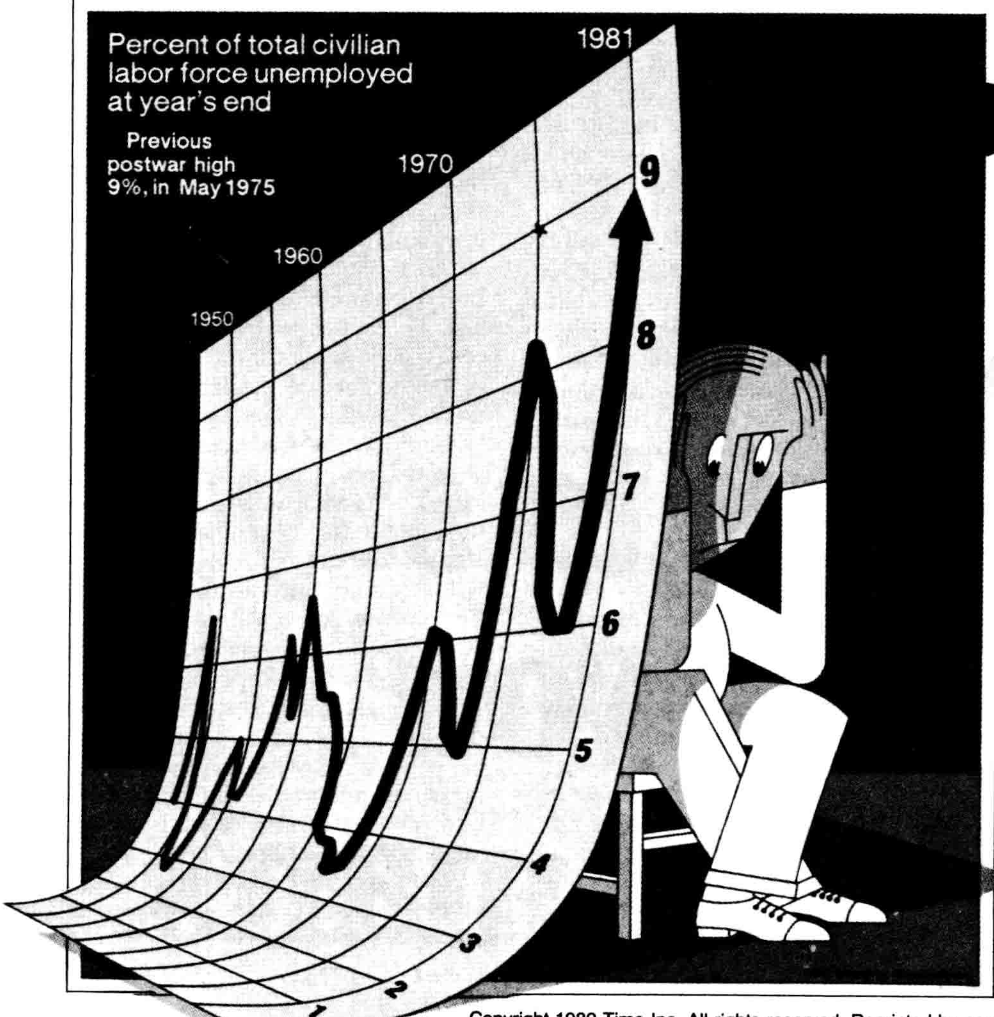
4

Unemployment On the Rise

Fewer benefits mean harder times for the jobless

It is one of the most watched, and most politically potent, of the monthly economic figures issued by Washington, and it keeps creeping upward. The unemployment rate in the U.S. last December reached 8.9%, in contrast to 8.4% the previous month and 8% in October. In human terms, the number meant that 9.5 million American workers had no jobs in December. This week the Bureau of Labor Statistics will announce the unemployment rate for January and it will almost certainly be up again, perhaps surpassing the previous postwar record of 9% reached in May 1975.

The growing jobless rate comes at a crucial time for the nation, since the Reagan Administration's economic program of budget and tax cuts is only now beginning to take effect. As the President pointed out in his State of the Union message, a 1% jump in the unemployment rate raises the federal deficit by $25 billion because of lost taxes and additional unemployment benefits. For the first time in years, polls show that more Americans are worried about unemployment than inflation. The jobless rate, if it keeps climbing, could well become the primary focus of the political debate right up to the November elections. At stake are not just Republican fortunes in the House and Senate, but Reagan's effectiveness as President in wooing Congress to do his bidding. Says one White House official: "You don't lose elections because of inflation. You do lose elections because of high unemployment. If unemployment breaks 10%, we're in big trouble. And if it's not down to 8.5% by the election, it's going to have serious consequences."



It is doubly troublesome that the ranks of the jobless are growing at a time when many of the cushions softening the pain of unemployment have been deflated. Reaganomics has whittled away at unemployment compensation and has tightened eligibility rules. At the height of the 1973-75 recession, for example, more than 75% of the 8.4 million jobless Americans received benefits; last December only 37% of those out of work got unemployment compensation. By eliminating 300,000 public service jobs provided by the Comprehensive Employment and Training Act (CETA), the Reagan Administration shut off a source of work that has been both praised as a safety net for minorities and damned as a boondoggle. Finally, there have been major cuts in public employment services, which placed 3.7 million people in jobs last year, including 583,000 who had been drawing unemployment benefits.

Traditionally, Congress has tried to bring down unemployment with public works projects and public service jobs. But those familiar panaceas have been largely discredited, and even many Democrats are skeptical that old methods should be tried again. Says Massachusetts Senator Paul Tsongas: "We've been down that road before. It doesn't produce anything." The legislation being offered now to fight unemployment would stress job training for the private sector, not creating public jobs. Democrat Ted Kennedy, who last week called unemployment "the No. 1 issue now nationwide," has joined forces in the Senate with Republican Dan Quayle of Indiana to sponsor a $4 billion job-training program. In the House, California Democrat Gus Hawkins has proposed a $5 billion training program that would allow local officials to use some of the funds to create public service jobs. House Speaker Tip O'Neill has criticized Reagan for the growing unemployment lines, but so far has not suggested a plan of his own. An aide to the Speaker may inadvertently have best summed up the Democrats' plight. "Our alternative is that the President should advocate an alternative," said the spokesman. "That's our alternative."

Unemployment has historically been a good issue for Democrats, as inflation has been a good one for Republicans. Yet for all the White House worries about G.O.P. fortunes in the fall, it is not clear that Reagan will suffer much politically. Interviewing the jobless across the nation last week, TIME correspondents found relatively few who blamed the President for their plight. Rudy Barker, 62, was laid off in 1980 from his job at a lumber mill in Willamina, Ore., and he has not worked since then. "All this started before Reagan," he says. "It's been coming on for the last two or three Presidents." Says Samuel Ehrenhalt, Middle Atlantic regional commissioner for the Bureau of Labor Statistics: "A lot of people are just not ready to call it quits with the President."

In pushing its revolutionary program of budget and tax cuts to cure the nation of nagging economic ills, the Administration realized that some suffering was inevitable. Indeed, the White House anticipated a rise in unemployment during the early stages of the program; it was felt that a hike in joblessness was necessary to dampen wage demands and cool inflation, which Reagan regarded as the nation's chief economic problem. But Administration officials never expected that the rate would surge so high or inflict so much hardship.

When Reagan took office last January, the unemployment rate stood at 7.4% and the President's Council of Economic Advisers, headed by Murray Weidenbaum, predicted that the average annual rate for 1981 would be 7.8% and that it would rise to 8% for at least part of the year. Instead, the rate dipped to 7% in July, but then began climbing again as the economy started to buckle, partly because of high interest rates. The exorbitant cost of borrowing especially plagued the automobile and construction industries, which in turn affected their suppliers, such as steel, rubber and timber firms. With orders down, layoffs of workers spread.

The surging interest rates were caused in part by the Federal Reserve Board's tight grip on the money supply, a policy designed to bring down inflation. But there is little agreement about other causes. Officials of the Fed blame ballooning budget deficits for kindling more fears about inflation and thus keeping interest rates high. Administration officials complain that the Fed's erratic control of growth in the money supply scared lenders into keeping interest rates high. Whatever the cause, most economists now agree that the unemployment rate will gradually rise into the summer, perhaps hitting 10%, before beginning to dip again. White House officials fervently hope that by fall the rate, no matter how high, is headed in the right direction—down.

High unemployment is not unique to the U.S. It is afflicting other Western industrial democracies as well. (Although Communist bloc nations profess to have no unemployment whatsoever, the severe troubles afflicting their economies belie that ideological stance.) In Canada the jobless rate is 8.6%, up from 7.4% the year before. In the ten nations of the European community, the unemployment rate stands at a postwar high of 9%, leaving more than 10 million unemployed. In France the rate is 8.7% (up from 7.5% in December 1980), in Italy 9.1% (up from 8.3%). In West Germany the figure is 7.3%, the highest since 1956. After the announcement last week that the unemployment rate for Britain and Northern Ireland had reached 12.7%—which meant a record 3 million out of work—Prime Minister Margaret Thatcher was greeted in the House of Commons with opposition cries of "Resign! Resign!"

Joblessness in the U.S. takes on many faces and breaks into many patterns, and some of the trends displayed in December's statistics are especially disturbing. Unemployment among blacks is a record 17.4%. The rate for teen-agers was 21.7% (for nonwhite teenagers the figure is a shocking 39.6%). "Discouraged workers," who have not looked for work in the previous four weeks and thus are not included in the monthly unemployment totals, reached a post-war high of 1.2 million during the last three months of 1981, up from 1.05 million the year before. And the number of people working part time, because their hours were cut below 35 a week or because they were unable to find full-time work, grew to a record 5.4 million, up 360,000 in a single month.

The unemployment rate for adult men jumped to 8%, a post–World War II high, from November's 7.2%. Economists consider this figure quite significant, since it indicates a growing number of layoffs among the traditional family breadwinners. The unemployment rate for adult

Less for More

As the unemployment lines are growing longer across the country, the jobless are discovering a painful lesson of Reaganomics: fewer of them are eligible for unemployment benefits, and many of those who do receive benefits are getting smaller checks.

Begun in 1935, under the auspices of the Social Security Act, unemployment compensation is funded by a combination of federal and state payroll taxes imposed on employers. Though benefits vary, most states give eligible workers a maximum of 26 weeks of unemployment pay. The checks, which are based on workers' previous earnings and length of employment, range from a weekly maximum of $222 in Alaska down to $90 in Alabama. By comparison, the average weekly manufacturing wage in September last year was $288.

Congress raised unemployment benefits considerably during the 1970s. If joblessness among workers covered by unemployment insurance reached 4% within a state, or if the rate nationwide topped 4.5%, for example, an additional 13 weeks of benefits were paid out; Washington and the states split the extra costs evenly. Under the Trade Adjustment Assistance Program, as amended in 1974, employees who lost their jobs because of foreign competition, such as auto and steel workers, received up to 70% of their wages for a maximum of 18 months. These jobless workers, whose numbers reached 281,000 in fiscal 1981, also received regular unemployment checks, and some of them wound up with more money after taxes than they had when they were working.

Then came the Reagan revolution. As part of its budget-cutting efforts, the Administration last August abolished the national unemployment trigger that provided an additional 13 weeks of benefits, but kept the individual state triggers intact. It is estimated that 640,000 workers will not get such payments during fiscal year 1982, for a savings to the Government of $690 million. Also stopped were unemployment benefits for servicemen who choose not to reenlist. The rationale was that military service during peacetime is an occupation, and those who leave voluntarily are in effect quitting their jobs. Finally, the budget cuts virtually eliminated the extra benefits paid under the Trade Adjustment Assistance Program. In December 1980, some 233,000 jobless were given such aid. Only 12,100 received it last December.

On Oct. 1, all states must raise their own trigger rates of unemployment that make the jobless eligible for 13 extra weeks of benefits by one percentage point, from 4% to 5%. In addition, new regulations will also require that any person drawing extended benefits must have worked at least 20 weeks during the previous year before losing his job; there is no such minimum requirement now. The logic behind these reductions in unemployment benefits was simple enough: the employer taxes that pay for them no longer cover the costs.

The most ironic cut of all involves the firing, for budgetary reasons, of more than 18,000 employees from the public employment service, which helps the unemployed find jobs and which is linked to the unemployment insurance offices that process claims. Since the firing is being done by seniority, many specialists in job placement may be reassigned to process benefit claims. The probable result: more errors and long lines for those trying to pick up their checks. The lines could well include out-of-work employment service clerks who once were on the other side of the counter.

women was lower than for men (7.5%), but the rate of joblessness among women with families to support was also a postwar record 10.7% during the last three months of 1981. And while the burden of joblessness still falls most heavily on blue-collar workers, it is spreading into the ranks of white-collar employees: from December 1980 to December 1981, white-collar unemployment rose from 4% to 4.6%.

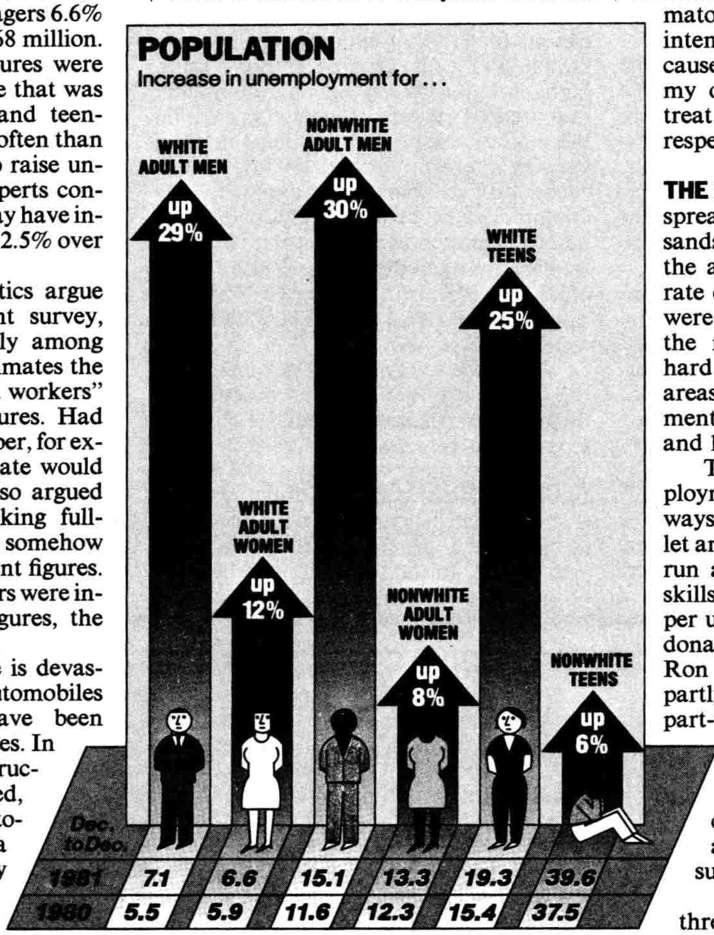
Other trends among the work force cloud the statistics. More women and teen-agers now seek jobs than ever before, pushing up the number of people in the labor market—and thus the number of unemployed. In 1955, for example, women accounted for 30.2% and teen-agers 6.6% of a labor force that totaled 68 million. In 1980 the comparable figures were 42% and 9% in a labor force that was 57% larger. Both women and teen-agers also change jobs more often than adult men, and this tends to raise unemployment rates. Some experts contend that these tendencies may have inflated the rate by as much as 2.5% over the past two decades.

On the other hand, critics argue that the Labor Department survey, which is conducted monthly among 60,000 households, underestimates the jobless because "discouraged workers" are not included in the figures. Had they been counted in December, for example, the unemployment rate would have reached 9.9%. It is also argued that part-time workers seeking full-time employment should be somehow included in the unemployment figures. If half of the part-time workers were included in the December figures, the rate would have been 11.5%.

The unemployment rate is devastating in two industries, automobiles and construction, that have been wounded by high interest rates. In December, 18.1% of construction workers were unemployed, and joblessness among auto-workers was 21.7%. That is a drop from 28.6% in May 1980, but auto industry figures are misleading. Many unemployed car workers have given up hope of returning to the assembly line and have sought different careers entirely. The downturn keeps spreading to industries that supply materials to automakers and house builders and is rippling through nearly all manufacturing firms. In past recessions, Government employment rolls tended to rise, but the Administration's efforts to reduce Government spending have stopped that trend. During the past year, 269,000 state and federal employees have lost their jobs.

One notable exception to the distress is in the so-called service-producing sector, which includes transportation, real estate and health care. The service fields employ 66 million people—three times as many as manufacturing firms—and have added 737,000 jobs over the past year. But even this market is softening: the rate of increase in these jobs last year (1%) was down from 1980's increase (2%).

The unemployment lines snake haphazardly across the country, with the Midwest, the Pacific Northwest and parts of the South suffering the highest rates of joblessness. Michigan, with its crippled auto industry, is at the top of the charts at 14.4%, with 627,000 unemployed. Oklahoma boasts the enviable rate of 3.9%, thanks to its thriving oil industry. A survey of the national unemployment scene:



THE NORTHEAST. For the most part, the states from Maine to Maryland have not been hit heavily by the recession. In November, the average unadjusted unemployment rate for the six New England states was 6.2%. The New England Economic Project, a consortium of public and private interests, forecasts the rate for the region will peak at 7.4% in the second half of 1982. Pennsylvania has troubles: the sagging steel industry helped push the state's unemployment rate up to 9.3%. One laid-off Pittsburgh steelworker recalled Reagan's comment two weeks ago that the newspapers were bulging with help-wanted ads. "I read the want ads too," he grumbled. "But I'm not a nurse."

Joseph Fetchik, 44, has been out of work since he was laid off from the Ford plant in Mahwah, N.J., 18 months ago. He signed up for benefits under the Trade Adjustment Assistance program, but the checks will stop coming this spring, and Fetchik cannot find a job. His wife Thelma earns $6,800 a year driving a school bus, but her salary will not nearly support her husband and two children. "I'm in big trouble, and my whole family is going to be in big trouble," says Fetchik.

Deryl Watson, 31, was fired from her $180-a-week job as a security guard at Newark public schools last September. An unwed mother with two children, she receives $168 every two weeks in unemployment benefits and $99 per month for food stamps. "We used to eat spaghetti and meatballs, but now we just have it with tomato sauce," she says. Watson has no intention of applying for welfare because "I want to work. I want to have my own money. Besides, they don't treat you right on welfare. There's no respect at all."

THE MIDWEST. Michigan's woes have spread to nearby states, forcing thousands of layoffs in plants that supply the auto industry. Both Ohio, with a rate of 11.8%, and Indiana, at 12.4%, were among the most ravaged states in the nation. Cities were particularly hard hit. There were 38 metropolitan areas in the U.S. where the unemployment rate exceeded 10% in November, and 14 of them were in the Midwest.

The pain and frustration of unemployment shows up in small yet telling ways. The Detroit *Free Press* offered to let any and all unemployed job seekers run a free classified ad touting their skills; nearly 5,000 people took the paper up on its offer. At a blood plasma donation center in St. Louis, Director Ron Wilson says business is up 10% partly because more housewives and part-time workers are coming in to collect the $8 paid for every pint of plasma. In Louisville, the number of people calling the city's crisis hot line and asking for food and clothing is up 32% from last summer.

Dzintra Dowling, 37, lives in a three-bedroom house in the Chicago suburb of Brookfield with her two children, ages 15 and 10. She has been out of a job since last October, when she was laid off at International Harvester. Dowling is separated and gets no financial support from her husband. Her weekly unemployment check of $199 ran out weeks ago, and she is "down to my last $20." She is now considering what would be to her a drastic measure: applying for welfare. "This morning I sat down after my son had gone to school and just bawled," she says. "It isn't because I'm worried about myself. It's, my God, what am I going to do with the kids? If it was just me, I could find a room somewhere and live on Campbell's soup and bologna sandwiches. But when you have children, it's different."

In Peoria, Ill., the Caterpillar Tractor Co. will lay off 1,700 workers this week,