

Midwest and sell the rights to dump sulfur into the atmosphere over Ohio, Indiana, Illinois, and Michigan. This would give all sides of the controversy the means to settle the issue among themselves, without waiting four, eight, twelve, or sixteen years to see what kind of policy emerges out of Washington.

How would it work? First, Midwestern utility companies would have to buy up some of the rights, in order to continue operating. The costs they incurred would be passed on to users of electricity—who would thus start paying the “external costs” of their consumption. These people would start conserving electricity—which is the exact, appropriate response needed to improve the situation.

Second, the people in Canada and New England would have the option to buy up some of the marginal rights and “retire” them, forcing polluters to cut back on their sulfur emissions. The marginal price of these rights would reflect two things: 1) the amount that Midwestern electrical consumers are willing to pay to go on polluting New England and Canada; and 2) the amount that pollution-conscious people in New England and Canada (or anywhere in the country, for that matter) are willing to pay to reduce acid rain.

As a consequence of all this, scientific studies would no longer be political footballs that experts throw

back and forth at one another. Instead, accurate information would become crucial in making the right decisions. Since people on both ends would be paying the cost of their choices, there will be a premium on getting the best information possible, rather than parading out wild exaggerations for the benefit of “policymakers” and the press.

Thus, all the right incentives would be in place. Power companies would look for the cheapest way to take sulfur out of the air—instead of stonewalling, as they do now. Consumers would conserve electricity, since they would now be paying the long-hidden external costs of their consumption. And the victimized states would be able to make realistic evaluations of how much pollution reduction they really want—instead of asking for the moon and getting almost nothing, as they do now. Costs would be shared, and people would get what they pay for.

The great virtue of such a system would be that all the parties would get to make their own choices in the matter—instead of having everything depend on who can put the most political pressure on the bureaucracy. It would get results—and efficiently, too—rather than continuing the endless rounds of scientific evaluations and court cases that are always grinding on in Washington, never leading anywhere. It would put the en-

vironmental decision-making back in the hands of the people.

The groundwork for these new approaches to environmental policy has long been laid. John Baden, Richard Stroup, and the young economists at the Center for Natural Resources and Political Economy in Bozeman, Montana, have written dozens of monographs and books dealing with government policies on Western lands. Paul Portney and Henry Peskin at Resources for the Future, and Robert Crandall at the Brookings Institution, both in Washington, have long elucidated the case for applying economic reasoning to environmental problems.

Even the major environmental organizations are becoming far more receptive. When I made a tour among the leading environmental groups a year ago, I found many of them had just put economists on their staff for the first time in history.

Environmental groups are obviously looking for compromise. They know the halcyon days of the early Carter Administration are gone forever. On many issues—like subsidized Western water projects—enlisting their support would probably mean nothing more than scheduling a joint press conference between the environmental groups and members of the Grace

Commission to announce their common objectives.

In fact, on many of these constructive proposals, it is probably business groups that will be the most likely to drag their feet. It's not that corporations don't like market mechanisms for pollution control. What they fear—quite rightly—is that these mechanisms will not replace existing regulation, but will only become another layer of bureaucracy superimposed on the current morass.

In fact, it is probably fair to say that—as with all market solutions—these policies have no real “natural” constituency. Market solutions are usually only acceptable as compromises of last resort. All parties will come to them only after each has abandoned the idea of winning the game entirely through outright control of the bureaucracy.

Yet it is precisely in these situations that political leadership becomes most important. Politicians can divest themselves of special interest groups, and play a truly constructive role in mediating between parties and setting up a system that works in everybody's interest. This is the kind of leadership opportunity awaiting the Reagan Administration in its second term. If environmentalism really is “everybody's issue,” there is no reason it can't be a big item on the agenda of the new Republican majority. □

Economy

FOCUS ON GROWTH

by Paul Craig Roberts

Despite the magnitude of his reelection victory, it will be difficult for President Reagan to put his economic policy back on track. Several important factors work against a return of his pro-economic growth program of 1981. One is the Federal Reserve Board's belief that economic growth causes inflation, a belief that makes the Fed reluctant to support an economic growth policy. Another is the failure of President Reagan to appoint senior officials who believe in his policy enough to fight for it. Yet another is the fight

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within the Republican party over control of the agenda and the 1988 nomination. The combination of these factors leaves President Reagan in a weakened and isolated position.

Indeed, despite his own supply-side rhetoric, Reagan's toleration of public displays of disloyalty to his policy on the part of his budget director, Council of Economic Advisers chairman, and chief of staff has resulted in the office of the presidency being used to discredit the President's policy. The President's men have succeeded in replacing economic growth with deficit reduction as the focus of policy. There is nothing wrong with deficit reduction. But it is being approached in a mechanical way that stresses tax increases and spending cuts and neglects the overriding importance of the economy's performance.

Part of the problem is the belief held

by many Republicans that the deficit determines the level of interest rates and, therefore, the economy's performance. This view is more political than economic and is based on many political campaigns against deficit spending. Republicans have opposed deficits for so long that they have forgotten that the problem is spending, and many are prepared to “fight deficits” by raising taxes. This is an unfortunate loss of vision, because spending should be cut even if the budget were balanced. It is government spending that “crowds out” the private sector regardless of whether the spending is financed by taxing or borrowing. Yet, many Republicans believe that only borrowing crowds out the private sector and that raising taxes prevents crowding out by balancing the budget.

Faced with this ingrained and inflexible Republican point of view, supply-

side economists in the Reagan Administration have found it difficult to get a hearing for empirical evidence. The evidence shows that deficits do not principally determine interest rates and that interest rates are not the main factor in the cost of capital. The impact of interest rates can be easily swamped by changes in taxation. These empirical and analytical facts are critically important for sound economic policy, but they have been lost in the general hysteria over the budget deficit. The supply-side argument has been cavalierly misrepresented by opponents as a claim that “deficits don't matter.” By crowding out evidence and sound thinking, the deficit hysteria is crowding out Reagan's economic program.

The deficit hysteria provides a convenient cover for Republicans who are determined to defeat the supply-side

policy in order to boost their chances for the 1988 Republican presidential nomination. Their goal is to raise taxes as a way of discrediting the tax-cutting policies of Rep. Jack Kemp, an obvious and attractive candidate for the nomination. If Reagan's supply-side policy is perceived as a success, much of the credit will accrue to Kemp, and he will be well positioned in the contest for the 1988 nomination. If, however, the policy can be presented as a failure that had to be reversed, Kemp's opponents can paint him as a purveyor of "crackpot theories," David Stockman's own charge with which William Greider ended the infamous article in the *Atlantic*.

The charge that the 1981 tax cuts are the source of dangerously large budget deficits is central to this strategy. The charge itself has the advantage of attracting powerful allies to the anti-Kemp political camp. For example, it pulls the Federal Reserve Board into the camp by obscuring the Fed's responsibility for the deficits due to its recessionary monetary policy. The charge also appeals to the largely liberal media and academic communities that prefer larger government. Many liberals view tax rate reduction as an immoral attack on the scope of government and as a restoration of private property rights that permits greater income inequality.

As long as Reagan is not prepared to take charge of his government, he cannot expect to achieve his goals. Large areas of policy have already reverted to the hands of the permanent government. The quixotic, Carteresque tax reform devised by the Treasury bureaucracy is a good example of the speed at which the permanent government has been able to reverse the direction of tax policy taken in 1981. With the main thrust of Reagan's policy so easily thwarted, it is not difficult to imagine what has happened elsewhere.

Without spokesmen and out-manuevered by career-oriented Washington regulars who, in the words of *Washington Post* editorial page editor Meg Greenfield, "will sell or sell out almost anything, including their own self-respect, if any, and the well-being of thousands of others" in pursuit of their personal ambitions, Reagan has little chance of leaving a permanent mark. Most of the troops who were willing to bleed for his policies in the Washington trenches have either bled to death or given up in disgust at their commander-in-chief's appointment of traitorous generals. The list of people who have left the Administration is a Who's Who of Reaganauts.

What does all of this mean? It means that Paul Volcker and the Federal Reserve Board are the main arbiters of economic policy. It means that Republicans are prepared to discredit the supply-side economic policy that reinvigorated their party and restored it to political competition in order to knock Jack Kemp out of the box. It means that the pursuit of power in Washington rather than the country's real problems absorbs the energies of policymakers.

Even if Reagan were prepared to take charge of his government and conduct a major house-cleaning, it is not clear where he would find the human resources for a renewed assault. There is an endless supply of people who desire presidential appointments for career reasons, but only a tiny number who are willing to put themselves on the line when they get the job. The incentive is to join the establishment, not to make an enemy of it. Those who are willing to fight are rarely even backed up by their friends.

A grim situation, however, should not cause us to lose sight of the fact that some changes did occur. Ronald

Reagan won election and re-election despite his aides. Taxes were cut in a supply-side manner despite the Administration's infighting and imperfect understanding of its own policy. Sometimes the few can catch the imagination of the public and prevail over the many. It happened in 1981, and it can happen again. Supply-side

reforms would leave open for debate the method by which the Fed should conduct monetary policy, but better accountability could improve policy while the debate is being conducted.

The tax system needs to be reformed in a way that makes it more neutral in regard to the taxation of saving. The multiple taxation of saving in the cur-

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economics is based on the incentives inherent in private property. It is the economics of a free society, and it will prevail if freedom prevails.

Therefore, the task remains what it has been—to fight for a free society. It would be a mistake to expect that any one President or administration can deliver this goal all neatly wrapped up in a pretty package. It would be a mistake to expect too much from a second Reagan term and an even bigger mistake to supply it with no people of character and principle. The establishment's encroachments on the Reagan presidency are not likely to be rolled back, but it is now our ground that is being encroached upon. We are further ahead than we were.

A free society respects property rights and does not give power to government without accountability. There is an obvious economic agenda consistent with these requirements. The Federal Reserve needs to be made accountable on the basis of principle and well-defined law, and the tax system needs to be reformed in a way that reduces its adverse impact on economic growth.

Discretionary monetary policy has not been successful. In the absence of clear rules, the Fed can substitute its own judgment. Since discretionary behavior is not predictable, uncertainty has grown in the financial markets. The effect of discretionary behavior on interest rates is greater than the effect of budget deficits. More importantly, the Fed's ability to behave as it sees fit means that elected officials risk having their policies crowded out by those of unelected officials.

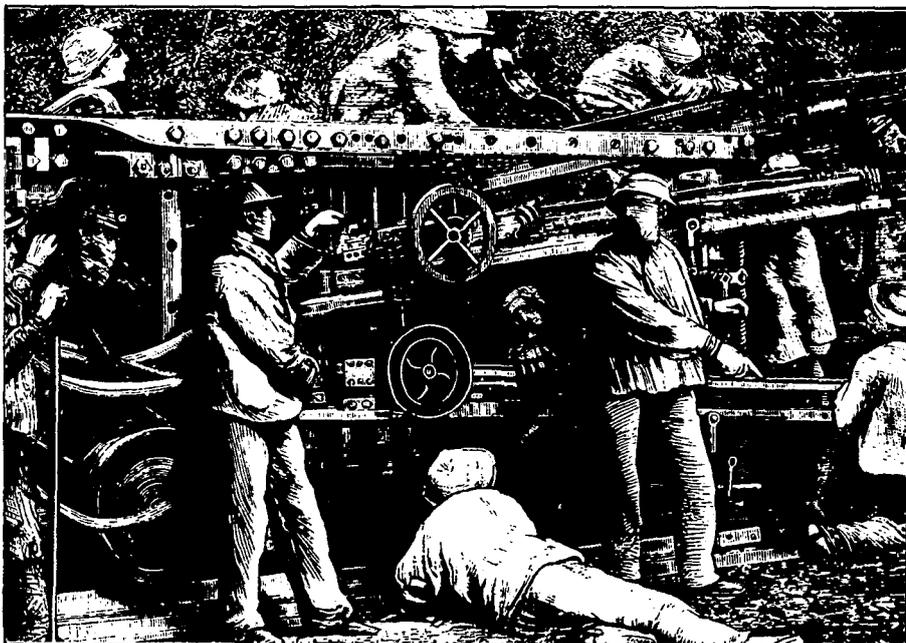
The Fed can be made more accountable without destroying its integrity. For example, secrecy could be reduced by requiring the Fed to announce all policy decisions when they are made. A reasonable measure of political accountability could be obtained by restoring the Secretary of the Treasury to membership on the Federal Open Market Committee and by making the Fed chairman's term of office concurrent with that of the President. These

rent code reduces the investment rate below what would be the case in a neutral tax system. A slower rate of investment means slower growth in the capital-labor ratio and labor productivity. In other words, a tax system that is not neutral with respect to saving retards the growth in real living standards. Neutral tax treatment of saving would reduce poverty far more effectively than government poverty programs.

Tax reform must be careful not to raise the cost of capital. This rules out the simple-minded approach taken by the lawyers and accountants in the Treasury's Office of Tax Policy (over the opposition of the Office of Economic Policy). The tax policy bureaucracy apparently thought it could strike a populist blow by reducing the average tax rate on personal income and shifting the burden to corporations by raising the marginal tax rate on new capital investment. On the surface this can be dressed up in the rhetoric of fairness and helping the little guy by making fat cats pay. However, when the dynamic effects are considered, it is obvious that it is no help to a worker to reduce his taxes in a way that hurts the growth of his living standard.

A wider issue is at stake. The future of the Western alliance depends on the free-trade posture that allows Europe and Japan access to U.S. markets. This posture is threatened by the sharp decline in U.S. productivity growth that occurred during the 1970s. The products of high-wage U.S. labor can compete in markets only if U.S. labor is more productive than its foreign counterparts. This has proved to be less and less the case. The basic reason for tax reform is to restore the competitiveness of U.S. labor in order that the Western alliance can be maintained.

Prospects for controlling the growth of government depend fundamentally on the performance of the private economy. The slower the economy grows, the more government spending must be cut back in order to reduce it as a percentage of GNP. But the slower



the economy grows, the harder it is to restrain government spending. This is why the key to budget control is a pro-economic growth policy.

The Reagan Administration seems to be gearing up for a massive assault on federal spending in 1985. The intention might be laudatory, but the strategy and tactics of budget-cutting are more complicated than many realize and the outcome could be disastrous. If economic weakness persists due to Federal Reserve policy and the

Treasury's anti-capital investment tax reform proposal, any gains from budget-cutting would be offset by the rise in the deficit due to economic weakness. Congress is not anxious to cut spending programs and will be even less anxious if spending cuts make no impact on the deficit projection (however much they might reduce the so-called structural component of the deficit).

The main effect of the assault on spending, then, might simply be headlines that budget director David Stockman and others can claim created

expectations of deficit reduction in the financial markets. The President will be advised, as he was in 1982, that the failure of the government to meet these expectations will result in financial panic and a rise in interest rates. If the economy is weak at the time, this argument will be particularly effective. Therefore, the main result of an assault on spending could be a tax increase to "make good on the expectations of deficit reduction that have been factored into the financial markets."

As the chart on page 200 of the 1984

Economic Report of the President shows, a significant portion of the multi-year deficit projections is due to an economic forecast that holds the economy below its growth trend for a decade. Obviously, the first step toward a sensible budget policy is an economic policy that returns the economy to its growth trend as rapidly as possible and provides incentives to capital and labor that increase the economy's growth potential. With this approach many things can be accomplished; in its absence frustration and disillusionment await. □

Constitution

STANDING TALL ON REALIGNMENT

by William Kristol

Three strategies will compete to guide the Reagan Administration in its second term in the area of civil rights and constitutional issues. These might be called the strategies of benign neglect, incremental rollback, and cutting the Gordian knot. Each can be supported by a plausible argument; each has distinct policy implications. Which strategy ought the President to choose?

Benign Neglect

Benign neglect must be judged the odds-on candidate to prevail. It for the most part guided the Administration during the first term, because it is the strategy that follows the course of least resistance, and therefore demands little in the way of political courage or daring. But beyond its natural appeal to the timid, there is a respectable strategic case for benign neglect.

That case is based on the judgment that the civil rights/constitutional area (that complex of issues ranging from affirmative action and busing to abortion and school prayer) is a minefield that conservatives cannot successfully navigate—at least for now; that advances on other fronts are far more likely; and that those victories, combined with a policy of hunkering down and holding the line in the civil rights/constitutional area, can set the stage for eventual success here as well. What is more, as we can see from the first term, precipitate and foolhardy sallies in this area actually endanger the prospects for an eventual breakthrough.

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Examples of such counterproductive efforts abound. In 1982, the attempt to resist virtual proportional representation by race during the re-authorization of the Voting Rights Act made the Administration the target of bitter criticism and the object of little gratitude—and failed. The judgment that nothing in the Internal Revenue Code prohibits tax exemptions for schools with distasteful racial policies called forth a firestorm of attack—and resulted in a humiliating 8-1 defeat in the Supreme Court in the *Bob Jones* case. And when the Administration did prevail in court, with its argument for a (somewhat) limited reach for the non-discrimination provisions of Title IX of the 1972 Education Amendments,

religion and politics made success among Yuppies possible—just as the muting of differences on women's issues enabled Reagan to minimize the effect of the gender gap. And surely the Republicans' strength among young voters rests upon the promise of economic growth and peace through strength, not on opposition to abortion, the ERA, or affirmative action.

Now, recognition of this fact doesn't mean that nothing can be done on constitutional issues; and the strategists of benign neglect do expect to make long-term progress on this front. Above all, there are the courts. By the end of his second term, President Reagan should have been able to appoint not only three or more Supreme Court justices,

Constitutional realignment cannot be brought about solely by the courts.

Congress came within a hair's breadth of overturning that decision, and indeed of broadening the scope of affirmative action regulations, through the Civil Rights Act of 1984. Such a bill is likely to pass in 1985. As for issues like abortion, school prayer, and tuition tax credits, it became clear early on that the votes were not there in Congress; there will be even fewer votes this session. Why expend political capital on fights that cannot be won?

Indeed—the case for benign neglect continues—it is not simply that these fights cannot be won. More important, they could alienate just those parts of the electorate that would be crucial to a lasting political realignment. This is clear from the 1984 campaign. Only the muting of the early emphasis on

but something like one-third of all federal judges. These judges can begin to check liberal excesses and restore sound constitutional principles without endangering the prospects for a Republican successor to Reagan—who would then be able to appoint more judges. That these judicial appointments need to be respectable, and to include a decent number of women and minorities so as to minimize opposition, is no real problem: Conservative ideologues should recall how foolish they now look over their bitter complaints about Sandra Day O'Connor. Similarly, conservatives complained when, during the election campaign, the White House refused to allow the Justice Department to intervene on behalf of the State of Washington in

its appeal of a federal judge's "comparable worth" decision. But it now looks as if the State will win on appeal anyway. The Administration thus avoided a politically damaging symbolic action; and, in fact, by refraining from making opposition to comparable worth a "Reaganite" position, the Administration may have made it easier for liberals (e.g., the *Washington Post*) to start raising serious questions about it.

The larger point this analysis suggests is that many of these issues can be bypassed rather than confronted, because history is passing them by. Judges are no longer imposing many new busing orders, and blacks are increasingly joining whites in requesting that existing ones be dropped; the sound conservative strategy is to focus the debate on quality education, and to allow busing gradually to fade away. Similarly, since the Court is going to allow states to chip away at the "wall of separation" preventing prayer in schools and aid to parochial schools, there is no need to make this a major national issue. And as blacks and women move into the employment mainstream, the whole problem of affirmative action will begin to solve itself. There is no point in picking bitter and divisive fights in order to make—and most likely fail to make—abstract points. Sound strategy is to focus on the winning issues of the future, not to refocus attention on symbolic issues of the past which only carry negative connotations for conservatives. This is the case for benign neglect.

It is a plausible case, if not an especially edifying one. But ultimately it is not convincing. For one thing, the