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THERE'S A CURE FOR WHAT AILS US!

By Herbert E. Markley

Herbert E. Markley recently completed service as President of The Timken Company and Chairman of the Board of the National Association of Manufacturers. He is presently Chairman of the Executive Committee of The Timken Company and Chairman of the Executive Committee of NAM.

He received a B.A. degree from Miami (Ohio) University, with membership in Phi Beta Kappa. He has received an Honorary Doctor of Laws degree from Miami University, Tri-State College in Angola, Indiana, and Malone College in Canton, Ohio, and an Honorary Doctor of Business Administration degree from Limestone College in Gaffney, South Carolina.

His current business and organizational activities include: Board of Trust Advisors of The Timken Company Charitable Trust; Board of Directors of The Firestone Tire & Rubber Company, Inc.; Senior Member of The Conference Board; and Member of the Ohio Development Advisory Council. He was recently presented the INDUSTRY WEEK "Excellence in Management Award."

Mr. Markley delivered this presentation at Hillsdale during the Center for Constructive Alternatives seminar, "Leading Corporate Heads Assess America's Future."

In considering the economic malaise in which we find ourselves, I recall the story about the ruler of a medieval kingdom who summoned his prime minister. Said the king, "I have been observing out the window for several days, and I perceive that the country is in serious trouble."

"But, sire," replied the prime minister, "That's not a window—it's a mirror!"

Our country today is beseiged by economic problems—energy shortages, inflation, signs of a possibly serious recession, and visible evidence of people's loss of confidence. The sickness that these symptoms mark is *real*, and it will not be cured without some pain and effort.

Our economic climate resembles a crisis atmosphere. Political figures intent on their own re-election are impelled to *do* "something," useful or no, so long as it will make a dramatic splash on the 6 o'clock news. But our problems are *not* brand-new. On the contrary, we are sick because our government has for years been applying the wrong remedies. The government appears to have learned *nothing* from years of applying the wrong solutions. As Will Rogers once put it, "Washington, D.C., is the only place on earth where sound travels faster than light!"

So the nation races merrily down the road to national bankruptcy, spending far more than our income and running the printing press to make up the difference, hurling huge amounts of money at intractable social problems, taxing heavily the productive elements of our society and turning it over as "transfer payments" to the *non*-producers, pursuing policies that *en*courage current consumption and *dis*courage investment for the future.

im•pri•mis (im-pri-mis) adv. In the first place. Middle English, from Latin in primis, among the first (things). . .

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And then some people actually wonder out loud how we got so sick!

There is, however, a built-in bonus. If our economic discomfort forces us to take a probing, thoughtful look at our problems and to start applying the *right* remedies, then the crisis in which we find ourselves will prove to be a constructive one. Almost 150 years ago, that shrewd analyst of American society, the brilliant French statesman, Alexis de Tocqueville, wrote these words: "The American republic will endure until the politicians find they can bribe the people with their own money." Are we near that point? It is up to Americans who love their country and wish to sustain it to prove that, in this one instance, the brilliant de Tocqueville was in error.

What have we, as a nation, been doing wrong that has caused our economic problems to worsen during the 1970s? Since our economy is admittedly *very* sick, what steps should we now take to get well? These are *very* straightforward questions, not that difficult to address. The trouble is that smiling politicians and professional demonstrators get these issues all entangled with efforts to "name the villain." There are, for example, at least three handy villains for our current energy ills: O.P.E.C., the oil industry, and the business community in general. Let's take a look at each.

O.P.E.C. It is tempting to blame the O.P.E.C. cartel for it all! After all, they *have* raised the price of their crude oil to dizzying levels, and we *are* experiencing gasoline shortages, increasing inflation, and the threat of a severe recession. But blaming O.P.E.C. may be about as helpful as blaming the law of gravity when you take a nasty fall from a ladder. O.P.E.C. imposed its most unpleasant price increases on us in 1974 and 1979—two years when our inflation was revving up to double-digit rates. In between, in 1975 and 1976, when we had gotten inflation *relatively* under control—down to 6%—all was quiet on the O.P.E.C. price-front. There's nothing very mysterious about it: O.P.E.C. is paid for their product in *dollars,* so they want more of them when the value is *declining*. Can you blame them? Of course, their hefty price increase *contributes* to inflation, and the vicious circle feeds upon itself. The O.P.E.C. nations will have no trouble collecting their price, however outrageous it may seem; so our best remedy is clearly to tame that inflationary dragon and get our economic house in order.

The oil industry. A favorite target these days is the oil industry that produces, refines, and markets the petroleum products for lack of which our economy would come to an abrupt halt. It's enticing to blame the oil industry for gasoline shortages and price rises; after all, they're *here,* they can be attacked on national television, and taxed and regulated half to death. Smiling, populist politicians visibly drool with pleasure at the prospect of imposing upon the oil companies punitive taxes not applicable to any other industry. While ranting about the oil industry's so-called "windfall profits," why do they not mention their "windfall losses" when they invest massive amounts of money in new refinery and pipeline facilities, or in dry holes?

Recently, we have been treated to a spectacle, as in the days of the Roman circus—political figures *competing* to demonstrate their dislike of the oil companies. That may be jolly fun, but does it solve any problems? This puerile notion that we can ease the pain and increase the supply of oil by treating those who supply it as public enemies is simply absurd. One need not be a captive of the oil industry to realize that regulatory harassment and punitive taxation will *not* encourage more oil production; that approach makes as much sense as attempting to increase our food supply by clubbing farmers over the head with the jawbone of an ass! Like crippled farmers, a crippled oil industry, publicly denounced at every presidential news conference, cannot be helpful in increasing our society's supply of things we need. Progress in reducing our dependence on oil imports from abroad can result only from massive new investments—billions upon billions of dollars—to expand our domestic productive capacity.

The business community. Well, how about the business community at large? Clearly an inviting target, especially the large corporations. Surely *they* can be blamed for the inflationary swamp in which the nation is floundering? After all, isn't it said that big companies have the power to set prices at will and scourge the rest of us with that inflationary whip? Some critics broaden their attack to include *all* elements of the non-governmental sector of the economy—business corporations, labor unions, supermarkets, you name it.

This approach—blaming inflation on the interaction of private parties in the marketplace—is attractive to some; it gives them an outlet to vent their spleen at organizations they do not like. And they can attach colorful labels to their favorite targets, like "greedy," "irresponsible," "outrageous," and so on.

Is this theory valid? Does it help us manage our problems? Inflation is primarily a creature of the last 15 years. Prior to that, from about 1949 to 1964, there were a few flare-ups, but over that entire 15-year span the price level rose only 30% or about 2% per year on the average. By contrast, in the 15-year period since 1964, prices have risen more than 150%—more than four times faster. Are we to believe that people have become more than four times as "greedy," corporations more than four times as "irresponsible," and price and wage behavior more than four times as "outrageous" as in the earlier period? *It defies reason!* In no way can it explain the *increasingly* serious inflation of the last 15 years, as compared to the tolerable limits in which inflation was contained in the preceding 15 years. There is no persuasive evidence that large organizations have become more powerful, more able to impose their "greedy instincts." With the massive governmental regulatory apparatus that has grown up, it is more likely that just the opposite is true.

None of these "designated scapegoats"—O.P.E.C., the oil industry, or the business community—passes our credibility test very well. So we must look elsewhere for the agent primarily responsible for our current sea of economic troubles. How about *government?*

Government. Since 1964, we have had the most activist government in our history. Through new initiatives, new regulations, and most of all greatly increased spending, government plays an ever-larger role in our lives—budgeting, taxing, spending, managing, regulating, controlling many aspects of our lives.

To what purpose? With all this government attention focused on the nation's economy, matters have steadily worsened. Over a recent six-year time span, while the cost of living in America rose 40%, the total tax bill jumped 65%. Inflation, now running at an annual rate of nearly 13%, pushes wage-earners into higher tax brackets, while their real purchasing power is steadily eroded. A recent U.S. Chamber of Commerce bulletin pointed out that in 1975 there were about *71* million people in the work force, and some *80* million people drawing government checks of one kind or another. The food-stamp program, which in 1965 cost $36 million, came to $6.8 billion in 1975. Former Senator Sam Ervin of North Carolina has estimated that *government,* at all levels, consumes about 40% of America's gross national product.

Do you now doubt why we are ill? *Surely,* there are strong grounds for the view that all this frenzied government activity, flailing about, hurling ever-larger sums of money at problems, issuing regulations at the speed of light, *has made our problems worse.* If one needs further proof, two commodities basic to our economy, fundamental to life as we know it, are bread and petroleum products: *bread* is relatively free of government controls, it is available in abundance, you don't have to queue up to buy it. *Petroleum products,* on the other hand, have been subjected to all sorts of controls, allocations, and authorized price levels. The result? Gasoline supplies are tight, you *do* queue up in some parts of the country, and some days try to find an open service station with any gasoline to sell! The moral suggests itself, but note one additional point: in the socialist "utopias" of the world, notably those in Eastern Europe, where the government controls *practically everything,* people queue up for bread, for gasoline, for *practically everything.* As Bill Simon, formerly Secretary of the Treasury and a distinguished predecessor at this podium, has put it, "Personal liberty without economic liberty is an absolute contradiction—the one cannot exist without the other."

If one digs into the root causes of the inflationary sickness of the 1970s, a huge clue appears. That clue has a name—"deficit financing." In every year since 1960 but two, the federal government has spent more money than it has taken in, and has merrily run the printing press to make up the difference. In our history, it took 173 years, from 1789 to 1962, for federal spending to reach the $100 billion-per-year level. Only *nine* years later, in 1971, it reached $200 billion. *Four* years later—note, please, the acceleration—we passed $400 billion, and *today,* ladies and gentlemen, *today,* it is over half-a-trillion dollars. That unbelievable figure, incidentally, is *53 times larger* than the federal budget just prior to World War II, and the cumulative national debt is now over $800 billion, or almost $4,000 for every American.

The "extra money" that these deficits represent becomes purchasing power. This "extra money," freshly printed to cover the government's deficit, competes with money from any other source (hard work, for example). Money chases scarce goods and services, the process feeds on itself, prices rise, so do wages and interest rates, savings become almost worthless. This mad game also has a name—it is called *inflation.* Any government can play.

An argument used to justify federal budget deficits has been the line that they help to maintain "full employment." By pouring out extra purchasing power from the printing press, the argument goes, government keeps the economy bubbling and holds down unemployment. You will *today* hear the argument that attempts to balance the federal budget are *heartless,* in the light of our national unemployment rate of 6% and rising.

Is that argument valid? We Americans *are* a decent and compassionate people. Most of us work hard and pay very high taxes, to support out of the public treasury the unfortunates of our society. The argument in favor of running large budget deficits as a means of holding unemployment down might be a useful idea *if it worked!* In truth, it is just the opposite. As the deficits rise, so does unemployment. During the 1970s—a period of an unbroken string of very large deficits—the unemployment rate averaged 6.2%, as compared to 4.5% in the 1950s and 4.8% in the 1960s. The "theory" holds neither water nor any hope for our economic good health. When we tolerate inflationary policies and wild government spending in the hope that they will reduce unemployment, we end up getting the worst of both worlds. A better solution by far is to get inflation under control, and let productivity and investment create new jobs.

At times, the government has tried another cure—wage-and-price controls, sometimes mandatory, sometimes by jaw-boning and arm-twisting. In this approach, government sets up rules mandating prices and wage rates, and then compels, cajoles, or demands that the marketplace follow those rules. Sounds comparatively simple—shouldn't that be a workable solution? In practice, it is a *nightmare.* Every time it has been tried, from the days of the Roman emperor Diocletian, 17 centuries ago, to the early 1970s, it has been a catastrophic failure. *Serious* shortages of goods and services inevitably develop, accompanied by gross inequities among the various groups in an economy; when the shouting is all over and the futile effort at controls is inevitably abandoned, the inflation is invariably much worse. When the wage-price controls of the first Nixon administration were lifted, the inflation rate surged four times as rapidly as when the controls began, two years earlier.

"Voluntary" controls—enforced by some very specific threats of retaliation against those who depart from the standard—are no different. The so-called "voluntary" wage-price standards of the current administration have already produced their own distortions: the inflation rate in the first six months of 1979, when the standards were in effect, was almost double that of the first six months of 1978, before the program went into effect. And there exists a *glaring* discrepancy between employees who do *not* enjoy cost-of-living adjustment clauses in labor contracts, and the large increases permitted for those who do. These inequities are *not* surprising. The longer artificially imposed controls are maintained, the more likely it is that major distortions will arise. In the face of a severe inflation, worsening month by month, it is ludicrous to expect mass compliance, and there seems to be little basis for the hope that controls can be fashioned into workable anti-inflation machinery. Controls are incompatible with what Adam Smith, some 200 years ago, termed "the system of natural liberty." More bluntly stated, *they don't work.*

A major evil of the recurring economic crises of recent years has been our tendency to muddle through the difficulties of the moment without much attention to the unspectacular but fundamental reforms that would greatly improve our economic health. If we were to draw up a balance sheet comparing the 1960s to the 1970s, we would note the following:

—the inflation rate (measured by consumer prices) has worsened, from an average of 2.3% to an average of 7.0%. *Today,* it is running at an annual rate of almost 13%.

—the unemployment rate has worsened, from an average of 4.8% to an average of 6.2%.

—productivity growth, measured as output per hour in the non-farm business sector, has fallen from an average of 2.5% to 1.2% (and *today* is running even lower, close to zero).

—annual balance of trade, which averaged a *surplus* of $4.1 billion in the 1960s, averaged a $7.1 billion *deficit* in the 1970s.

—research and development outlays, as a percentage of G.N.P., averaged 3.6%, a respectable figure, in the 1960s; in the 1970s they averaged 2.3%, a *reduction* of more than 30%.

Inflation, you may conclude, is the government's method for confiscating the taxpayers' property without due process of law. As long as government pursues the policies that it does, running a deficit budget, heavily taxing *production* instead of *consumption,* and seemingly doing everything it can to discourage investment, it cannot surprise us that inflation is increasingly severe.

Beyond debate, the most fundamental measure of our economic progress (and the only real source of improvement in our national level of living) lies in productivity growth. U.S. productivity growth in the 1970s has diminished, less than half of the growth in the 1960s. The general economic instability that inflation brings is simply *not* a happy climate for investment in new facilities, research and development, improvement of production processes, efficient allocation of resources, or, for that matter, high employee morale. So, output per man-hour is depressed, and stays that way—until we can get productivity climbing again.

Back in 1970, one could say with accuracy that never in living memory had the U.S. shown a deficit in the balance of its international trade. Year after year, since well back into the 19th century, our exports had *always* exceeded our imports. In the 1970s, this reassuring pattern was rudely shattered. During six years of the span from 1970 through 1978, we imported more goods than we exported. The balance-of-trade deficit figure for 1978 may make you catch your breath—it came to $34 billion. Is there a solution? Is there a cure for what ails us? Or are we collectively destined to mirror the taxpayer who wandered into the federal office building in a large city and asked, "Is this the headquarters of the war against poverty?" Told that it was, he replied, "Good, I have come to surrender."

There is, I submit, a far better option. It involves the revitalization of the American economy through the redirection of America's energies and talents. During the disappointing decade of the '70s, those energies and talents were depleted and misdirected by a hyper-activist government flailing about, hurling huge sums of money at every problem in sight. It did not even *begin* to work.

So the essential first step, if we are to start to get well, is to stop doing the things that made us ill in the first place—reckless government spending, deficit financing, declining productivity, unfavorable balance-of-trade, tax policies that discourage investment. *Those* are the narcotics to which our society has become addicted. If you wish to help a friend who is an alcoholic, the *first* thing you must do for him is to tell him, plainly and forcibly: *the cure for alcoholism is to stop drinking!*

But there is more. There are positive steps that can be taken to promote our collective healing. We need a clear concept, an affirmative vision of the constructive things that can be done—both by government and by the private sector—to make us whole again. The task that lies ahead of us, in the 1980s, is an awesome one. To revitalize our economy and our national self-confidence, after the present decade of turmoil and deterioration, will require heroic measures.

There are at least three major areas which demand close attention. They are: capital formation; productivity; and research and development. Let's take a look at each of these important areas:

1. *Capital formation* is essential to the investment process by which we provide the plant, tools, and machinery for future production. Our needs for new investment funds in the 1980s—to replace aging plants and equipment and to expand capacity—will be *enormous*. Part of our "cure," therefore, is relief from an ill-structured tax system that has severely curbed both the incentives for investment and the availability of funds. A new and welcome policy for government would be one that recognizes that high levels of capital formation are both possible and desirable. That could start our economic rebirth in the 1980s. One important step forward in this area is a major bill that has been introduced in the Congress. The bill is nothing less than a major reform of depreciation policy. Instead of the burdensome "useful life" concept to which business is largely bound, it establishes a straightforward period of time in which facilities and equipment can be written off: 10 years for plants and facilities, 5 for tools and machinery, and 3 for vehicles. This bill, when enacted into law, will be especially useful to small businesses whose capital resources are limited, and—to reiterate the point—will constitute a major step forward in the battle against inflation and economic recession.

Another measure that could help enormously in meeting our capital formation needs in the 1980s would be the repeal of the double taxation of dividends. As you know, the government taxes corporate profits, at the source, *before* distribution of any dividends. Then individual shareholders are taxed *again* on the dividends they receive—*two* bites on the same income. Not only is this grossly unfair (some would even say immoral!), but it is also very *unwise*, for it tends to dry up investment at the very point that we need to encourage it. A contra-indicated treatment, if ever I saw one!

2. *Productivity* is the useful output that we obtain, goods and services, in exchange for the manpower devoted to their production. Great productivity is what gave America the highest standard of living in the history of the world. A number of important factors have a bearing on productivity: the general stability and efficiency of the economy; the morale of workers and managers; the supply of energy; the availability of funds for introducing improvements in production methods—in short, we all need to work harder and more effectively if we are to get our country back on the productivity-growth track of earlier periods. As Senator Bentsen of Texas has recently put it, "Productivity is the linchpin of economic progress in the new decade."

The need to improve our productivity dramatically is so essential, indeed indispensable, to our economic well-being that it deserves more detailed examination on our part. If we are to compete effectively in world markets (including our own domestic market) with the energetic Japanese and the industrious nations of Western Europe, if we are to begin to tame the inflationary dragon that has been waxing ever stronger, we simply *must* improve our productivity, we *must* find the way to increase output of goods and services per man-hour worked. This is basic, this is key to the overall economic problem. What this clearly suggests is better use of our time, use of modern machines, and innovative, improved techniques and processes. These are all important, but I would particularly stress the effective utilization of time: it is a truism to say that time is money—*it is*—but as little as ten minutes per day wasted by each employee in a large plant can easily equate to millions of dollars annually, for that one company, or to many billions of dollars on a national scale. Just think how many jobs could be created, how many new machines could be installed. I think it is clear that there is a very direct linkage among productivity, capital formation, creation of new jobs, and restoration of a healthy economy, and that at the heart of all this lies the efficient utilization of what Sir Walter Scott termed "the ceaseless course of time." In this context, I would submit, time is our most precious and irreplaceable resource—to waste it nonproductively is, in my view, nothing short of sinful.

3. *Research and development* is really the base of the pyramid from which economic progress grows. Curiously enough, R & D appears to be both a cause and an outgrowth of economic dynamism. While there may be no simple formula for attaining a higher level of R & D, it *needs to be done*—we all need to work at it. It will take some time and cost some money.

Well, what's the bottom line? If we are indeed to get well—in addition to pulling the "abscessed tooth" of excessive government activism—if we are to solve the problems of inflation, recession, energy shortages, and unfavorable balance of trade on something other than a crash, short-term basis, there is a series of *specific actions* for the near future that deserves immediate application. Here, if you please, is my seven-part prescription to cure what ails us. Like most strong medicines, it may taste a little bitter, but it will make us well:

1. *Balance the federal budget for fiscal year 1981*. The President smilingly promised to present a balanced budget for 1981, in the budget message to be sent to the Congress in January, 1980. If he caves in for any reason—fear of recession, or the loud cries of his anguished constituencies in an election year—or if the Congress makes it impossible to achieve that goal, then we are doomed to relive the inflationary trauma of the past several years. Do you remember the words of George Santayana, at Harvard? "Those who do not learn from history are condemned to repeat it." Many brave words have been uttered, throughout the 1970s, about balancing the budget "eventually," but it has long since been time to *do it*.

2. *Eliminate all direct government controls of wages and prices.* Whether these are mandatory controls or so-called "voluntary standards," they are an artificiality, they create great distortions and inequities, they simply *do not work.* The remedy is really quite simple: give the free-market economy a chance!

3. *Eliminate controls on the prices of petroleum products, and dismantle the whole apparatus of government allocations.* We have had an object lesson on how badly these things are managed by government. In Japan, for example, and in Germany, there are no price controls on gasoline and no government-mandated allocations—there are also no gas lines at the service stations and no shortages on weekends. Those who advocate nationalization of the U.S. oil industry—"run it as a government corporation!"—really should examine the operations of Amtrak and the Postal Service! *The free market economy works best.*

4. *Reappraise all government regulations that increase the costs of production.* No responsible citizen—least of all, myself—questions the need for some government regulation, to protect the health and safety of the public. That is a legitimate function of government. The issues, however, are the *degree* to which regulation is reasonable and the *balance* between the good to be attained and the costs required to attain it. Conforming rigorously with the flood of regulations that issue from Washington costs the business community an enormous amount of money—we are speaking here of billions upon billions of dollars. These costs can only be recovered in the prices charged customers for goods and services. Sometimes, the results achieved by regulation are *worth* the additional cost; sometimes, they are *not*. A systematic, objective reappraisal of all government regulations bearing on the cost of doing business is clearly in order, particularly in the light of the startingly higher cost for energy these days.

5. *Reform the federal tax system so as to encourage a higher rate of capital formation.* A useful step in the right direction would be abandonment of the cumbersome system of depreciation allowances based on the concept of "useful life," and substitution in its place of a modern system of capital consumption allowances for the rapid recovery of investments in fixed capital. I endorse the recent proposal that we discussed earlier, for a simple, straightforward system of depreciation: 10 years for plants and facilities, 5 for machinery and tools, 3 for vehicles.

6. *Increase the focus by business, labor, and government, on measures for raising our productivity.* This is a key step in curing what ails us. In the recent time-frame, the increase in the national productive output of goods and services per hour worked by all employees has been essentially flat. The President's Council of Economic Advisors, in their annual report of several months ago, reported that productivity in the private economy rose by only 0.4% last year. So there *is* a great deal of room for improvement, and the productivity increases that we can achieve are one important way of getting inflation under control.

7. *Renew the attention to research & development, as the means of opening new opportunities for economic growth.* Experience clearly indicates that nations that support research & development are generally more successful in the world market than are those that do not. There must of course be a balance between our ability to develop new technology and our ability to apply that technology to the needs of the marketplace. Innovative, financial, and productive resources can thus work together to create new products, improve productivity, and help slay the inflationary dragon. The enormous growth in our economy between the end of World War II and the late 1960s was largely the result of technological advances—we can do it *again*.

It's a tough world, and we face very tough problems. If we were to adopt, to the full, my seven-part prescription, our sickness would *not* disappear overnight. But we *must* begin to take the measures that will lead to a restoration of economic health and well-being. We live in a changing world, which in turn demands adjustments in the *way* we live and the way we produce goods and services. Some of the "adjustments" will be painful, true, but far less so than if we allow this sickness to continue, untreated and unchecked.

One thing I would urge, to this audience of young Americans who will be the leaders of our society in a few years: *do not lose hope!* Do not surrender to despair. The great French novelist of the early part of this century, Marcel Proust, once wrote, "Always try to keep a patch of sky above your life." We are confronted by serious, even critical, issues—who can deny it?—but there is no need to despair. We *can* solve our problems, we *can* restore our national self-confidence, we *can* open the way to a new era of great achievement in an ambiance of political and economic liberty, *if we but have the will to do so*. Otherwise stated, America can once again be what it has consistently been for two centuries, the hope and envy of the world.

Editor, Ronald L. Trowbridge.