CONGRESSMAN'S REPORT
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The Silent Revolution in Economics
II--"Forgive Us Our Debts?"

In the first report of this series I outlined the revolutionary changes in government policy which have occurred in the last five years. In this second report I want to analyze two important and often emotional concepts that figure in our recurring debate on government finance: debt and inflation.

Once again I want to emphasize I am writing as a reporter, not an advocate, because I believe it's important that you and I be aware of the new ideas now being tested and the results they may be achieving. In these reports I am presenting as fully as I can the case for these changes because I think the contrary arguments are obvious, familiar and known to us all.

THE OLD IDEA -- 'CASH AND CARRY'

I used two examples in my first report of drastic changes in public attitudes -- the 1932 vs. 1964 presidential campaigns, and the 1965 excise tax cut in the face of a federal deficit and a booming economy. Let me refer to my own experience as a third example:

> ** When I was growing up in a small community, my father -- a very honorable, prudent and practical man -- had attitudes similar to those of most Americans. He never made a major purchase, be it car, house or appliance, until he could pay the full price in cash. To my father, as to many Americans in past generations, debt was not simply unwise; it was immoral.
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> ** By the time I went out into the world a change already had taken place in our society. Unlike my father, I proceeded to use credit, to buy things on time. Nearly everyone in my generation does. What parent today would advise a newly-married couple to shun the FHA mortgage or the installment loan and to withhold any purchases until they could pay cash? But if Americans generally followed such policies, imagine what a depressing effect this would have on our automobile, home-building and appliance industries -- and on the workers and stockholders who now gain from all this production.

It is a plain fact that the American way of life, and the fantastic American economy, are run on a fuel called debt. Because Americans have confidence in themselves and their future, they have gone into debt right now for a whopping total of $810 billion -- more than 2 1/2 times the federal debt. What's more, they are paying their monthly installments with remarkable regularity. Today's rate of installment delinquency is a striking 1.5%, or, to put it another way, 98.5% of all installment contracts are being paid as scheduled.

LIKE A COIN, DEBT HAS TWO SIDES

Debt, the economists tell us, is not simply an unfortunate and undesirable by-product of our productive and affluent society; it is the fuel which makes the engine run. Like a coin, debt has two sides. The chattel mortgage you give your auto dealer is just a piece of paper, but our system gives it value. To you it is an obligation or debt. To the dealer it is something else: an asset or credit. Because people like you pay their debts this paper acquires value when you sign it. The dealer can take it to the bank, exchange it for money, and use the money to hire employees, buy still more cars, expand his business and, yes, pay his federal taxes!

WHY CAN'T THE GOVERNMENT BE LIKE AT&T?

I know an intelligent, elderly lady who is quite conservative in her views. Among her investments over the years has been a substantial block of stock in American Telephone and Telegraph Co. To this lady AT&T is the very symbol of sound, safe, well-managed business that pays its bills.

Talking of the federal debt one day, she demanded to know why the federal government couldn't be like AT&T. This prompted me to do some checking, and I discovered that between 1929 and 1962 AT&T increased its debt some 630%. Imagine, 630%! This didn't sound like the AT&T my friend was talking about. Well, is it still sound after all that deficit spending? Of course it is. AT&T is a bigger, more prosperous, sounder company because it has used debt to expand and grow. While it has more debt today than it had in 1929, it also has more income and more assets to handle that debt.

In the late 1940s Sewell Avery of Montgomery Ward decided that his company would wait until it had sufficient cash, and prices were right, before expanding its operations. On the other hand, Sears Roebuck, his biggest competitor, borrowed heavily and built a lot of new stores. The result was a near-disaster for Montgomery Ward and a tremendous success for Sears Roebuck -- further evidence of the value of debt in our economy.

HOW HIGH IS UP? HOW BIG IS BIG?

Debt, like most things, is relative. It must be related to the debtor's assets and income and potential. If I owe a million dollars, this is a very serious matter; if AT&T owes a million, it is not. Whether a particular amount of debt (for a government or for a business) is dangerous, unwise or irresponsible depends on these other factors.

A person or a government with $10,000 income can handle more debt than one with $5,000. A person or government with $50,000 in assets can handle more debt than one with $25,000. And a government deriving tax revenue from 20 million people can handle more debt than one with only two million.

Since 1946 our federal debt has increased by $50 billion. It now stands at $319 billion. Let's test this larger debt against these critical factors.

THE INCOME FACTOR

In 1946 our Gross National Product was $211 billion, our federal debt $269 billion. In other words, we owed 127% of a full year's national income. Today our debt is $319 billion, but our Gross National Product is $649 billion. Our debt now represents less than 50% of a year's income. If our debt and Gross National Product were to continue to increase at present rates, we would find ourselves in 1975 with a debt of about $350 billion and Gross National Product of $1.1 trillion. While our debt would be still larger than it is today, it would amount to only 32% of a year's income.

Grudging as I am to accept any of these new ideas, I might be inclined to respond to all of this in this way: All right, debt isn't all bad! I'll admit it! But at least you will have to admit it's a burden. We have to pay interest on it, and this money has to come from somewhere. Why increase this burden?

The answer I would likely get is this: Take 1961. In that year we were paying $9 billion in interest on the national debt. Surely no sane man would have advocated adding to this burden -- but we did. And the results? Today the interest cost is $11.6 billion, but revenues are up $27 billion -- enough to pay the old interest cost three times over.

Suppose, the argument goes, we had decided against those tax cuts and budget deficits. Would we be better off? In all probability we would have $27 billion less to meet our obligations, and we would be adding to the national debt anyway, by accident, unintentionally.

In fact, that is precisely what happened to President Eisenhower in 1957-58. Trying to head off a recession, he slashed expenditures in order to balance the budget. In so doing he reduced government demand for America's goods and services, and we ended up with both a recession and a $12 billion federal deficit, the largest in peacetime history.

THE POPULATION FACTOR

In 1946 our national debt of $269 billion was shared (in the sense that an individual can "share" his country's assets or liabilities) by 142 million Americans. This was a debt <u>per</u> <u>capita</u> of $1900. Today with more debt we have 53 million more people to "share" it, and the per capita debt stands at $1630. If this program of selective tax cuts works and our population growth continues, we will find ourselves in 1975 with the larger debt cited above, but our per capita debt will be something like $1500.

THE ASSET FACTOR

My friend who admires AT&T probably understands that this large company is sound and needn't worry about its debts because the company's financial statements balance off these debts with huge assets. Unfortunately, we don't do this with our federal debts. Unlike a private business, we (a) ignore the federal government's assets and (b) lump capital expenditures in with operating expenses. It is little wonder that people get alarmed when they look at this kind of an "annual report."

If you stop and think about it, the federal government has enormous assets -- almost beyond calculating. It owns national forests of immense size with timber of exceedingly great value. It owns post offices in almost every city in the country. It owns millions of acres of real estate, fleets of airplanes, hospitals, air bases, highways, ships -- the list is endless. And obviously these things <u>are</u> assets.

One indication of the federal government's assets is the periodic report of the Committee on Government Operations of the House of Representatives. This appraisal of federal assets is as conservative as they come; for example, the 481 million acres administered by the Bureau of Land Management is carried in the report at 1 1/2 cents an acre, and the famous Hope Diamond (worth between $200,000 and $2 million) is ignored entirely because it was donated to the government. Yet even on this conservative basis the government's assets are listed currently at $324 billion.

How much more the federal government has in assets can only be estimated because such a task defies conventional appraisal techniques. I have often seen the figure of a trillion dollars, and I think this, too, may be conservative. For example, I recently read a news release indicating that the newly-discovered federal oil-shale properties in the Rocky Mountains are valued at more than $300 billion.

Whatever the figure is, I think we can see that the federal government has substantial assets which more than balance with the debt we know so well.

A BOOKKEEPER'S NIGHTMARE

Suppose a businessman has sales of $100,000 and expenses of $90,000. We could all agree that his budget is balanced. Now suppose he were to take this $10,000 profit, borrow $5,000 more, and build a branch store to help his business grow. His accountant would <u>still</u> show this businessman with a $10,000 profit; the books would <u>also</u> show a new $15,000 investment along with a $5,000 debt. Obviously, the $15,000 would <u>not</u> be treated as lost, squandered or frittered away.

Unbelievable though it is, that last is precisely the way Congress has always insisted that every dollar spent for capital improvements be treated. It is as though money spent to build a new post office was <u>lost</u>, irretrievably, once the contractor was paid.

Let's use a specific example right in Arizona. The federal deficit this year is estimated at about $4 billion. Suppose we were to pass the $1 billion Central Arizona Project, and the dams and aqueducts could all be built and the money spent in the next fiscal year. Would this cost be depreciated over the life of the project -- say 1% a year? No. The federal budget would treat this money just as it treats a corporal's salary or money spent for jet fuel. Spent and gone. And our $4 billion "deficit" would now be $5 billion. Under these circumstances one can easily imagine the arguments that would be used in Congress against our project. "This is fiscal irresponsibility," our opponents would cry. "Let's wait until we have cash in hand before we build this project."

Suppose the Congress accepted these pleas for "fiscal responsibility." Would the country be better off? On the contrary, it would be poorer. Construction of the project would pour a billion dollars into our economy, stimulating business. Out of this in perhaps 10 years would come an increase in the Gross National Product of, say, a half-billion dollars per year. This represents about $60 million in tax revenues, $600 million in 10 years -- all in addition to the regular repayment of the project loan. Would we have benefitted by waiting? Obviously not.

We have seen that most private citizens use debt as a tool to acquire <u>now</u> the buildings and tools they need in their business endeavors, and the homes and autos which make their personal lives more comfortable. These uses of debt are generally accepted, as are comparable practices of school districts, cities and states. No one suggests that this year's parents must pay the whole cost of an elementary school constructed this year but good for the next 30 years. School bonds spread these costs over many years and many sets of benefitting parents. Yet many people who approve such practices by individuals and local governments would insist that the Central Arizona Project remain unbuilt until the federal budget is in balance.

It has been suggested, and I'm inclined to agree, that we're guilty of a kind of "double standard" -- one set of rules for private citizens and local governments, another for our federal government.

BUT HOW ABOUT INFLATION?

"All right," I might confess, "we have expanded our economy by the deliberate act of spending more than we take in -- by accumulating more debt. But hasn't this been at the price of an increase in the cost of living? Surely a sound dollar is more important than all of this."

The answer I would likely get is this: Our dollar is doing very well, thank you. In fact, it is retaining its value better today than at any time in recent decades. And this is no small accomplishment.

Many people imagine that inflation is a recent phenomenon, probably originating in the New Deal. Actually, we have always had some inflation! A dollar bought less for Lincoln than for George Washington. But the inflation of this century is a by-product of the industrial revolution and the growth and wealth arising from it. Inflation wasn't a serious problem before 1890, but as the economy began to take off prices moved too. The 1890 dollar dropped to 79 cents by 1917; by 1929 it was worth only 61 cents. In these 39 years we usually had a balanced budget.

Those who think that inflation is the No. 1 Evil and complete price stability good might suppose that <u>deflation</u> would be even better. Suppose that a year from now your dollar would buy 25% more. Wouldn't this be good? Actually, the periods of deflation in this country haven't been very happy times, as a moment's reflection will show. The 1890 dollar, down to 61 cents in 1929, actually <u>rose</u> to 70 cents in the four years 1929-33. Dollars bought more, <u>but no one had any to spend</u>. One-third of the labor force was idle; one-half of our factory capacity was closed.

Those who say that New Deal spending devalued the dollar have little solid history to go on. By 1940 the dollar was at 65 cents in 1890 purchasing power, still above 1929.

Since World War II the pattern has been a steady advance in consumer prices and decline in dollar value, at an average rate of about 2% per year. Since 1961, however, and during this new program of tax cuts -- the rate has been less than 1% per year!

In any case, it means little to talk about inflation without talking about changes in real per-capita income. You can't ride to work on a dollar bill, or eat it, or live in it. It's what you can buy with your current income that counts. Everyone dreams of yesterday's prices in terms of today's income, but never yesterday's prices in terms of yesterday's income. The purchasing power of the 1890 dollar was down to 40 cents by 1947, but real weekly earnings (that is, earnings related to what the dollar will buy) had increased 100% during the same period.

Putting it another way, pork chops now cost 90 cents a pound; 50 years ago they cost 21 cents. But today the average worker can earn the 90 cents in 21 minutes; his grandfather had to work 57 minutes to earn the 21 cents.

There are people who still think of the late 1920s as a heyday of low taxes, small federal debt, sound government and plenty of money to spend. The fact is that -- after allowing for inflation and after allowing for higher taxes -- the per capita income of Americans is 77% higher today than it was in 1929. So inflation, too, is relative.

TIMING IS WHAT COUNTS

None of the leading economic advisors argues that you should never balance the federal budget. Nor is anyone saying that inflation has ceased to be a problem that must be watched carefully. It can be dangerous and serious. Even the advocates of federal deficits acknowledge that deficits can cause inflation in certain circumstances.

A classic example occurred in 1946-50. At the end of the war money and savings were plentiful, and goods were scarce. A huge supply of money was chasing a very short supply of houses, autos, refrigerators and other goods. A big federal surplus would have held inflation in check until the factories could convert to civilian goods. Instead, Congress prematurely abolished rent controls and cut taxes. The result was inflation in a heavy dose.

The economists are saying only that the 1961-65 program of tax cuts and deficits has not caused abnormal inflation. We have doubled our rate of economic growth while holding inflation to half the level of the 1950s. These two factors are what make the experiment an apparent success.

TWO DOWN ONE TO GO

In these first two reports we have been dealing with the results and dangers of our new economic policies, and with the traditional arguments against them. As I mentioned earlier, I believe most Americans will apply one test and one test only to these new ideas: Do they work?

While it may be difficult, I think it is important to try to understand why and how these seemingly unsound ideas work, if they do. In the next report we will tackle some confusing words like "fiscal drag" and "aggregate demand" and see if they have any real meaning or application to our economy.