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DAVID D. BOAZ
Policy Analyst

March 25, 1981

Mr. Morton Blackwell
Assistant to the President
The White House
Washington, D. C. 20500

Dear Morton:

Congratulations on your appointment. Remembering your stories of your service on the Arlington Board of Consumer Affairs, I look forward to hearing that you have persuaded your colleagues to abolish the executive branch.

Pending that day, I do hope you will be able to have a positive impact on the course of the administration.

In case you don't see any of the Cato Institute's publications regularly, I enclose a recent copy of our economic newsletter, Policy Report. We have a new series called Policy Analysis beginning soon, and I will see that you are on the list for it.

Best of luck.

Sincerely,

David D. Boaz

DDB/st
Enc.

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POLICY REPORT

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Competition, Antitrust, and the Ready-to-Eat Cereals Case

by D. T. Armentano

The Federal Trade Commission (FTC) antitrust case currently pending against the leading ready-to-eat (RTE) cereals manufacturers presents a timely opportunity to review critically the theory of antitrust policy.[1]

For too long antitrust policy has been relatively immune from the criticism that has devastated other governmental regulations and policies. For example, some economists have argued that government regulation tends to produce results *opposite* to those intended; curiously, however, antitrust policy has rarely been offered as an instance of this well-known phenomenon. And while there have been dozens of revisionist studies demonstrating that business interests historically have supported "regulation" in order to restrict competition, no such revisionist study has yet appeared to unmask the Sherman Antitrust Act.

In short, antitrust policy has more often than not been taken at face value as a policy whose "sole purpose" has been to protect consumers from restricted outputs and higher prices.[2] There are now signs that this essentially naïve perspective no longer commands universal acceptance.

For a number of years, some academic scholars have been severely critical of much of antitrust theory and policy.[3] They have argued that many of the cases brought by the FTC—especially those regarding mergers and tying contracts—have been anticompetitive in their effect and have raised costs and prices. When the courts condemn "economies and efficiencies" as a restraint of trade and a violation of the antitrust laws, even the most ardent antitrust defenders are forced to run for cover.[4]

D. T. Armentano is a professor of economics at the University of Hartford and author of *The Myths of Antitrust*.

"Why has competition been attacked in order to preserve and protect it?"

While this criticism has been important within certain academic circles and in some court decisions, the more fundamental issue yet to be addressed is: *Why* were such antitrust cases brought in the first place? Why did the government believe that it was promoting competition by instituting proceedings against competitive business organizations engaged in essentially competitive conduct and performance? Why has competition been attacked in order to preserve and protect it?

The answer to these questions is at the heart of the antitrust problem. The government and many academic economists have accepted a fundamentally incorrect theory of competition and monopoly power, and this unfortunate theory, in turn, has resulted in absurd antitrust cases. Bad ideas always have (bad) consequences.

Competition and Monopoly Theory

Within the older, classical economic tradition, *competition* was seen (correctly) as a rivalrous process between business organizations for the favor of buyers in the market.[5] Alternatively, *monopoly* was associated with legal barriers to entry that protected existing producers from competition. For classical economists the appropriate public policy to combat monopoly power was obvious: Remove government restrictions and competition would flourish naturally. Even laws preventing business collusion were unwarranted since they could not be executed in a manner "consistent with liberty and justice."[6]

During the 1920s and 1930s classical competition and monopoly theory underwent a major transformation. Competition, formerly understood as a rivalrous disequilibrium process of market adjustment, was transformed into a static, equilibrium condition where resources were routinely allocated as "efficiently" as possible. This metamorphosis was accomplished by focusing attention not on the process of adjustment itself, but on the end-state equilibrium condition that might appear as a *consequence* of the process. Thereafter, competition became associated with many small firms producing homogeneous products, with a total absence of interdependence (formerly the very essence of rivalry) and advertising or marketing of any sort. The problem of accounting for market information (and the process by which plans are corrected) was simply ignored by assuming that information was perfect. "Competitive" firms were now firms that did *not* compete, did not change the nature of the product or its price, did not innovate or market new products, and did not earn economic profits in the long run.

This new theory of competition also

(Cont. on p. 3)

EDITORIAL

No Quick Fix for Social Security

Millions of American workers received a rude surprise last month: The social security bite out of their paychecks rose from 6.13% to 6.65%. The maximum income subject to the tax increased as well, from $25,900 to $29,700, so that the maximum tax paid by an individual will increase from $1,587 to $1,975. Of course, all these numbers should be doubled because the employer's share of the tax rose along with the employee's share. Economists now recognize that the "employer's share" of the tax is just another cost of labor to the employer and thus is ultimately paid by the employee. Social security, therefore, actually takes 13.3% of most workers' paychecks, up to a maximum of $3,950.

Almost all American workers are subject to this tax increase. The major exception is employees of the federal government, who have wisely exempted themselves from the social security system. They have their own retirement system, with decidedly better benefits than those offered by social security.

This year's rise in the social security tax is the latest in a series of increases mandated by Congress in 1977. That law was called the largest peacetime tax increase in American history.

Yet even that massive tax increase did not make the social security system solvent. By 1980, just three years later, the system's trustees reported that social security would run out of money to pay benefits as early as 1982. The system currently has only enough money in its "trust fund" to pay three months' worth of benefits, down from 13 years' worth in 1950 and one full year as recently as 1970. Even a minor economic dislocation—hardly an unlikely event in a world of double-digit inflation and 8% unemployment—could exhaust the trust fund.

Most observers now recognize that social security is in trouble. Even President Reagan's advisers recommended some changes. But the changes being proposed do not face up to the real problem. They are "quick fix" solutions designed to get us past the next few years. When politicians propose such quick fixes, we may assume they just want to get past the next election. When respected economists offer piecemeal solutions, they may believe that only such answers are politically feasible. Yet if the proposals that are perceived to be politically feasible are in fact not sufficient to solve the problem, it is incumbent on policy analysts to make that fact known. Such insistence on real solutions can help to change what is politically feasible.

What sort of solutions to the social security problem have been proposed?

Some experts recommend raising the retirement age for social security from 65 to 68. This proposal would allow for a small reduction in the payroll tax after it was implemented, but it would not solve the system's basic problems.

Others have suggested that social security benefits be indexed to prices rather than wages. This would have some beneficial effects, but again the system's problems go much deeper than this. Such a reform might delay the collapse a few years, but would not prevent it.

The Reagan transition team recommended forcing new federal employees into the social security system. Such a proposal would seem to accept the "chain letter" nature of social security, suggesting that the only way to pay present recipients is to find new taxpayers. Although it is certainly unfair for the federal government to require the rest of us to participate in a system from which its own employees are exempt, the answer is not to extend the near-bankrupt program but to begin cutting it back.

None of these proposals actually faces up to the real problems of social security. These problems stem from a basic contradiction between the two objectives of the program, to provide welfare and to provide insurance. Trying to meet both objectives, it has met neither well. It does not provide adequate benefits for the truly needy, and it does not provide a good return on investment to those who have paid into it all their lives.

It has never been an invested pension fund, as most Americans probably think; rather, it is two separate programs, a tax and a dole, tied together under one name. When any such pay-as-you-go system reaches its mature phase, as social security has, it is no longer able to meet its obligations.

These problems require major reforms. We must begin to look for a system that will provide better retirement benefits at a lower cost. Such a system has been outlined by Peter J. Ferrara in his study *Social Security: The Inherent Contradiction*, published by the Cato Institute. He proposes to fund current social security benefits out of general revenues—as will almost certainly have to be done anyway—and to allow younger workers to invest in private plans *instead* of social security. In a few years the burden on the taxpayers would be relieved, and new retirees would receive better benefits from their private investments.

There may be other proposals as good as Ferrara's. What must clearly be rejected is any piecemeal solution. The problems of social security are too fundamental to allow us the luxury of a quick fix. ■

The RTE Cereals Case (Cont. from p. 1)

produced a far more general approach to monopoly and monopoly power. Legal barriers to entry were now broadened to include any entry difficulty that new business organizations might face in order to compete with established firms. And, importantly, this allowed "industrial organization" theorists to treat product differentiation, scale economies, and advertising not as elements of competition, but as "barriers to entry" that would "foreclose" and "exclude" competition.[7] In short, the concept of business competition was turned around; the essential elements of competition were said to indicate "monopoly" and a "misallocation of resources." That strange antitrust cases would follow this theoretical inversion should come as no surprise.

The RTE Cereals Case

Against the background of this short history of theory, the current FTC action against the leading cereal manufacturers can be clearly understood. The cereals industry conveniently contains all of the ingredients needed in the "modern" approach to monopoly power. The industry is "concentrated," with the four largest firms selling over 80% of the ready-to-eat cereals. Concentration has stayed "persistently" high for many decades. The firms reportedly avoid price competition and almost always follow the leader (Kellogg) when increasing their market prices. The profits of the companies have stayed persistently higher than the normal or competitive return on investment. Finally, and most importantly, the dominant firms maintain their market position by introducing dozens of new cereal types ("brand proliferation"), which has had the effect of restricting new entry into the market and thus restricting "competition" in violation of the law. The remedy sought for such antisocial behavior will be to force the leading companies to license out their trademarked cereal brands to companies currently shut out of the market.[8]

As we have previously argued, this emphasis on product differentiation as a barrier to entry is certainly not accidental. For decades students of economics and antitrust policy have been told by economic theorists such as Joe Bain, Richard Caves, Walter Adams, William Mueller, and William Shepherd that product differentiation (and most often a "frivolous" differentiation) is the most important barrier to competition and is primarily responsible for allocative inefficiency. We should not be surprised, therefore, that such theories have finally been taken seriously by those now responsible for public policy in this area.

Product Differentiation

The argument that product differentiation misallocates resources by deterring entry and competition has been raised in previous antitrust cases, but it has never been the central issue—or, indeed, the *only* issue—as it is in the current cereals case. The FTC argument (actually the argument of Professor Richard Schmalensee) is that brand proliferation by the existing companies so "crowds" the "product space" that there is virtually no room for additional brands by new entrants.[9] New entrants are deterred from entering the market since the risk of failure of a new brand is high and the brand-specific fixed costs (especially advertising) are considerable. Thus continuous brand introductions by the existing companies "exclude" competition and "foreclose" the market to new competition. Even though the leading companies continue to earn "monopoly" profits, entry is effectively barred.

Although this argument may appear plausible, it is riddled with difficulties. Putting aside for the moment the issue of monopoly profits, the actions of the existing companies are completely compatible with intensely competitive market behavior. Indeed, the FTC is not objecting to monopoly, but to the rigors of the competitive process in RTE cereals. For instance, we are told that it costs millions to introduce a new

(Cont. on p. 4)

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The RTE Cereals Case (Cont. from p. 3)

cereal. We are told that the risk of introducing any single new brand is extremely high. We are told that the established companies introduce new brands (84 between 1952 and 1973) and fill product "holes," or gaps, quickly—so quickly in fact that new business organizations cannot possibly respond.[10] And finally we are told that all of this production—and it *is* production—is ultimately "exclusionary" of competition.

Now if all of this sounds familiar, it should, since it is a variation of Judge Learned Hand's arguments in *Alcoa* (1945).[11] In that case Hand argued that Alcoa "preempted" competition by investing in productive capacity and expanding its outputs of aluminum ingot *before* potential competitors could or would. Alcoa forestalled competition by purchasing water-power sites and developing them, thereby improving its own industrial efficiency. Alcoa anticipated increases in the demand for its products and efficiently filled that increased demand, employing superb management and an "elite" personnel. But all of this was not inevitable, concluded Hand. Alcoa's behavior indicated that it meant to maintain its (near) monopoly position in the market by engaging in these specific "exclusionary" practices.

That these so-called exclusionary practices in *Alcoa* were all efficient practices and productive of economies and benefits for buyers has now been widely admitted. Yet the "exclusions" in the present case do not differ in kind from those in *Alcoa*. After all, the cereal companies were not restricting output and repressing innovation. They were admittedly engaged in activities aimed at holding (or increasing) their market share, and these activities involved introducing and advertising new products (or variations of older products) and expanding the production of those products. That such activity was accomplished *successfully* is the very essence of the FTC complaint and the very heart of the matter. If the firms had misinterpreted consumer demand and not introduced brands, they would have lost market share, and there would have been no FTC case. If the firms had misidentified consumer demand and introduced the wrong brands, they would have lost market share, and there would have been no FTC case. If the firms had failed to advertise and market their products successfully, there would have been, again, no FTC action. Thus it is the success of private planning and production that is at issue in this case, just as it was in *Alcoa*, and no bias against sugar cereals or children-directed TV advertising ought to divert our attention away from this essential issue.

"The essential elements of competition were said to indicate 'monopoly' and a 'misallocation of resources.'"

Profits and Resource Allocation

For many economists, and even for some of the critics of antitrust policy, the fact that new entry has been relatively modest and that profits for the leading companies have stayed high presents some major difficulties. Why, they ask—if the industry is indeed competitive—do profit rates stay far above normal for extended periods of time? And is not such performance an indication of monopoly and resource misallocation?

The first point to be made is that even neoclassical competition theory admits that disequilibrium profits need not be "normal." It is only in long-run competitive equilibrium that firms (should) earn a competitive rate of return. And since cereal outputs are expanding and new products are being constantly developed, it is obvious that the industry has not yet reached any final equilibrium. Thus high profits, even from the perspective of the critics, do not unambiguously indicate resource misallocation.

Further, there is no reason to expect any rivalrous process, especially one involving highly differentiated consumer goods, to *ever* reach an equilibrium with normal profits. Although equilibrium is admittedly a useful pedagogical notion, we should not get carried away and expect such theoretical constructs to actually exist in reality. Economists are taking their theoretical models far too seriously and as a consequence are committing grave methodological errors. Unfortunately, these theoretical errors have rather grave policy implications in this case.

Entry

There are several additional points to be made with respect to market entry in the cereals industry. The first is that entry need not be accomplished by totally new firms, but can encompass expansions in capacity by existing firms, too.[12] The FTC insists on using the term in a manner that is not even consistent with neoclassical practice. Since capacity in the cereals industry has increased in response to increases in demand, there certainly has been entry, although it has not been the sort of entry (high-cost, new-firm entry) that the FTC would seem to prefer.

But even admitting that new entry has been limited is admitting too much. For the fact remains that there has been "entry" (even by their definition) into the industry, although that entry has occurred in special product areas, e.g., natural cereals. All of the FTC-alleged "barriers to competition" were not enough, it seems, to prevent successful market entry and competition in natural cereals. Why this competition fails to destroy the entire logic of the FTC case against the cereal companies is not immediately obvious.

Finally, the FTC has argued that the high profits cannot be explained as a return to high risk since the cereals industry, as indicated by the historical stability of its earnings, is hardly a

high-risk industry. Yet earnings are stable despite the high risk associated with brand introductions (consumer taste in cereals being very unpredictable) precisely because the large companies are able to invest in a portfolio of brands and thereby spread the risk of any single brand failure. From the perspective of the potential small entrant, the industry is extremely risky, and entry is, accordingly, deterred. The profit returns would have to be even higher, perhaps far higher, to encourage entry into most of the RTE brand areas. Rather than charge that profits are too high, the FTC should more logically have argued that profits were kept artificially low (given the risk) to discourage entry and competition.

In conclusion, the RTE cereals case is another antitrust disaster in the making. It is both a travesty of justice and an abuse of sound economic principles and reasoning. But all of this is unlikely to deter the FTC persecution and the ultimate examination of these issues in court. By 1985, if we are lucky, we may find out whether selling Cocoa Puffs and Cap'n Crunch at a profit is really in the public interest. ■

[1] The FTC complaint against Kellogg, General Mills, General Foods, and Quaker Oats was Docket No. 8883 and was filed April 26, 1972. (The Quaker Oats Company has since been dropped from the complaint.)

[2] Alan Stone, *Economic Regulation and the Public Interest: The Federal Trade Commission in Theory and Practice* (Ithaca, N.Y.: Cornell University Press, 1977), p. 24.

[3] Some of the most prominent critics of antitrust (often associated with Chicago and UCLA) would include Yale Brozen, Harold Demsetz, Wesley J. Liebeler, Richard Posner, and Robert Bork (Yale Law School). Two book-length criticisms would be Posner's *Antitrust Law: An Economic Perspective* (Chicago: University of Chicago Press, 1976) and Bork's *The Antitrust Paradox* (New York: Basic Books, 1978). For a more radical criticism of antitrust theory and policy, see my own *The Myths of Antitrust: Economic Theory and Legal Cases* (New Rochelle, N.Y.: Arlington House, 1972).

[4] Economies and efficiencies have in fact been explicitly condemned. See, for instance, the argument in *Brown Shoe* v. *U.S.*, 370 U.S. at 294.

[5] For an excellent review of classical and neoclassical competition theory, see Paul McNulty, "Economic Theory and the Meaning of Competition," *Quarterly Journal of Economics* 82 (1968).

[6] Adam Smith, *The Wealth of Nations* (New York: Modern Library, Random House Edition, 1937), p. 128.

[7] See any leading industrial-organization text, or see a new (but still incorrect) treatment, Douglas Greer, *Industrial Organization and Public Policy* (New York: Macmillan, 1980).

[8] These assorted findings of "fact" are all contained in the four-volume FTC Staff Report, "Complaint Counsel's Proposed Findings of Fact, Conclusions of Law, Order, and Supporting Argument," September 30, 1980 (available from the FTC for $82.28).

[9] Ibid., p. 256–392.

[10] Ibid., especially pages 249–50.

[11] *U.S.* v. *Aluminum Company of America*, 148 F.2d 416.

[12] Yale Brozen, "Competition, Efficiency, and Antitrust," in *The Competitive Economy: Selected Readings*, ed. Yale Brozen (Morristown, N.J.: General Learning Press, 1975), p. 11.

Regulatory Watch

DEPT. OF HOUSING AND URBAN DEVELOPMENT

Federal regulation of private housing, which began 50 years ago under President Herbert Hoover, has reached such staggering proportions that the nation's basic housing laws now fill over 1,350 pages of small print, an amount that is expanding daily. The authorized housing budget of the Department of Housing and Urban Development (HUD), the agency that administers most of the federal housing programs, will exceed $27 billion in fiscal 1980. Many of the federal housing purchases contain commitments to pay for housing over a long period of time. The federal government presently has $230 billion worth of such commitments.

HUD estimates that the typical American household spends about 19% of its income for housing. This is a larger share of income than for anything else—except taxes.

The Housing Act of 1949 establishes "a decent home and a suitable living environment for every American family," as a national goal. In its attempt to fulfill this goal, the federal government now directly subsidizes the housing of over twelve million households. A Congressional Budget Office study has estimated that the total costs of the direct and the indirect subsidies to public housing tenants will average somewhere between $6,700 to $12,300 a year per unit, depending on the rate of inflation. If this amount were provided directly to the tenants, it would enable them to rent almost any new, privately built apartment.

HUD has approved almost forty thousand construction projects for the upcoming fiscal year. Under the Public Housing Program, local housing authorities are expected to buy projects built by private developers, and the job of the federal government is simply to pay the bill. The planned apartment units will have an average cost of $57,000 per dwelling, not far below the median price of a new home, $63,000.

Under Subsections 221(d)(3) and 236 of HUD's Section 8 (loan management and property disposition), occupants of subsidized housing units are tied to that unit if they wish to retain their subsidy. If the occupant leaves his unit to take a better job, for instance, he loses his subsidy.

HUD has recently been experimenting with a new method of lowering mortgage interest rates: the "local mortgage revenue bond," a device that uses the proceeds of tax-free municipal bonds to finance home mortgages. Although several billion dollars' worth of bonds has been issued, the initial aim of the program, to increase the homeowning opportunities for lower-income families, has not been achieved, because most of the funds have gone to middle- and upper-middle-class buyers.

Rent Control and the Poor

by Charles W. Baird

Rent control is a specific type of price control, and the relationship between price controls and the poor has been well stated by Gary Becker, an economist at the University of Chicago:

> Price controls are almost always rationalized, at least in part, as a desire to help the poor, yet it is remarkable how frequently they harm the poor. The difficulty intelligent laymen have in understanding this is testimony to the insights provided by even simple economic analysis.[1]

To be poor does not mean having to pay high prices. To be poor means having purchasing power (real income) less than some minimum amount. If the market price for some good increases, that merely signifies that something has happened to reduce the availability of that good relative to the ability and willingness of people to pay for it. A price increase informs all market participants of the change in the supply-demand situation and causes them to adapt their plans and actions to that change. Prices that people pay in uncontrolled markets are the terms of participation in the market process, while real incomes that people receive as sellers in the market determine the extent to which they can participate in the market process as buyers. Poverty is not the result of high prices—it is the result of not having much to sell that others are willing to buy.

Attempts to diminish poverty by preventing price increases are self-defeating. The proscription of price movements greatly diminishes the efficiency of all economic activity and, therefore, ultimately must lead to lower incomes for most people. In an economic system of voluntary exchange, people receive incomes primarily by selling the services of the resources they own to others who, in turn, employ the resources in the production of goods and services. Incomes to resource owners are paid out of the revenue producers receive when they sell what they produce to willing and able buyers. Resource owners of all sorts can receive large income payments only if their resources are used to produce those things that buyers really want and are, therefore, willing to pay to get. The pattern and intensities of wants can only be accurately communicated by prices that are allowed to become whatever the market will bear. The price that the market will bear for a good is the only operational measure of the good's value that exists. When sellers attempt to discover such values for all goods, they benefit all of us, because it is only with knowledge of these values that resources can be directed toward uses that generate high incomes for resource owners. The only effective approach to the problem of poverty, therefore, is to allow the price mechanism to work to its full extent in each market. Only then can we be sure that the flow of income payments is as large as it could possibly be.

"The only tenants who benefit from rent control are those that stay in one apartment for a long period of time."

People own unequal quantities and qualities of productive resources. Therefore people will receive unequal income payments as they sell the services of those resources. The market value of a person's labor services, for example, might be low because of a physical handicap or lack of education and training. The value of such a person's labor services is not enhanced by laws restricting price movements. To the contrary. Price restrictions lead to the inefficient use of all resources and, therefore, reduce the earnings it is possible for such a person to realize. The plight of such a person can be relieved only by improving the quantity and quality of the resources he has to sell and by removing all legal impediments (e.g., minimum wage laws and compulsory union membership) to their sale. Where that is not possible, it makes more sense to grant cash subsidies to such a person than to prevent markets from functioning. Malfunctioning markets generate poverty.

Incomes and Rent Control

In New York City, rent control has long been advocated as a measure to help the poor. Indeed, the plight of the poor seems to be the most effective propaganda in the arsenal of New York's rent control advocates. Yet in 1979 rent control in New York City seemed to do at least as much for the rich as for the poor. The mayor of New York, for example, lived in a rent-controlled apartment at $250 a month. The estimated fair-market value of that apartment—what the rent would be in the absence of control—was $400 to $450. The president of the American Stock Exchange paid $660 a month for an apartment with a fair-market value of $850 to $1,200.[2] Many New Yorkers with relatively high incomes inhabit rent-controlled apartments.

The only tenants who benefit from rent control are those that stay in one apartment for a long period of time. This is so even when the rent control ordinance extends to newly vacated apartments. When rents are controlled,

Charles W. Baird is a professor of economics at California State University, Hayward. This article is excerpted from *Rent Control: The Perennial Folly* (San Francisco: Cato Institute, 1980).

Briefs

☐ According to a survey by the Capitol Hill Women's Political Caucus, female legislative assistants in the House earn an average of $3,000 a year less than their male counterparts. Female assistants in the Senate get about $4,000 less than males, while the yearly earnings of Senate female field managers is $9,000 less. Women can do little about this situation because Congress has exempted itself from the Equal Pay Act of 1973 and the antidiscrimination provisions of the National Labor Relations Act.

☐ "Presents are showering on Congress as never before," according to *U.S. News & World Report*, and it's considered neither illegal nor "unethical" as long as the gifts are publicly reported. Show horses, antique firearms, golf equipment, purebred dogs, club memberships, and vacations are only a few of the freebies that have been given to members of Congress. No fewer than 54 congressmen listed gifts of trips (with expenses paid) to resorts or foreign countries to give speeches, attend conferences, or make "fact-finding" tours.

Says Sen. John Tower (R-Tex.), whose $2,000 honorarium and expenses for a five-day speaking trip to Honolulu were paid by the National Consumer Finance Association: "As a member of the Banking, Housing, and Urban Affairs committees, I get invitations to speak to groups that have an interest in the legislation we handle. Obviously, things that happen in a resort are more suspect, but I put in the same amount of work. These groups have a right to representation, a right to ask questions."

☐ The Navy has spent over $150 million during the last 12 years to administer an automated centralized pay system for its military personnel. The system is considered so unreliable that local disbursing officers are forced to calculate pay figures manually in order to check the computer. Each payday, over half of the paychecks must be changed to agree with the correct total.

☐ A top Energy Department official has estimated that it will cost American taxpayers $45 million a year just to keep the DOE's gas-rationing plan on the shelf and ready to go. Most of the money will be needed to run periodic checks on state motor vehicle registration files, on which gas allotments will be based, and to maintain local rationing boards.

☐ The amount of money collected in property taxes has nearly doubled in the last decade despite a growing tax revolt that has led to such measures as California's Proposition 13. In 1969 the cost of property taxes was $32.5 billion; in 1979 it stood at $63 billion. Over the same period of time the gross assessed value of the property subject to taxes rose only 11.8%. ■

it becomes difficult to find a vacant apartment. If one is forced, by a job change or something else, to move, there ensues a long and expensive search for a new apartment. On the average, people with lower incomes move more frequently than those with middle and upper incomes.[3] This means that where rent control ordinances specify decontrol at vacancy, people with lower incomes will face larger rent increases than others; and it also means that the poor face the burden of apartment hunting under rent control much more often than others. When we recall that indirect rationing by price and nonprice rationing devices is often employed under such restrictions, we must at least doubt that rent control helps the poor.

Most people assume, without even pausing to think about it, that landlords affected by rent control are typically richer than their tenants. Actually there is some evidence that this isn't true. The author of an early study of rent control in New York concludes:

> I do not want to argue that the evidence presented indicates that landlords are poorer than tenants. But the data certainly do not indicate the contrary—that landlords have significantly higher incomes than tenants. Thus, if one of the objectives of rent control is to aid low-income people—and I can find no other important objective that rent control does achieve—it does not achieve that objective. Undoubtedly, there are relatively poor tenants renting from relatively rich landlords, but the converse must also exist.[4]

While this particular study was done in 1951, there has never been any presentation of data that suggests the situation has changed.

Middle- and upper-income people are owner-occupiers of their dwelling units to a much greater extent than lower-income people. Since rent control creates a shortage of rental housing, some of the demand for rental housing spills over into the market for owner-occupied units. This results in higher prices in this market than otherwise would exist. This is a clear gain to owner-occupiers who acquired their homes prior to the price increase, but it is not very good news to those who are forced by rent control to seek housing in owner-occupied facilities. Here again, the poor seem not to benefit from rent control as much as others.

Environmentalism and the Poor

Environmentalists and other antidevelopment people have been successful in decreasing the supply of all kinds of housing, both rental and owner-occupied, relative to the demand for housing. In some cases—e.g., Mountain Village in Oakland, California—the actions of the antidevelopment people have changed proposed developments from ones that offer many units with a wide range of prices and rents to ones that offer fewer units on large lots with only very high prices and rents. In some cases—e.g., San Bruno Mountain in San Mateo County, California—antidevelopment forces have been able to get proposed developments completely cancelled.

(Cont. on p. 8)

✓ Washington Update

✓ For the first time, the total cost of campaign spending rose to over $1 billion. This figure, which includes $250 million for the presidential campaign, $350 million to elect members of Congress, and some $400 million to choose governors, state legislators, and other officeholders, is nearly twice the 1976 figure of $540 million. The biggest spender in the House was Robert Dornan (R-Calif.), with $1,578,143; the biggest spender in the Senate was Alan Cranston (D-Calif.), with $2,711,192; and the most expensive gubernatorial race was run by John D. Rockefeller IV (D-W.Va.), at a cost of $11,648,091.

✓ The Federal Food and Drug Administration has ruled that manufacturers of infant formulas must submit reports every 90 days confirming the nutritional value of their products. This action was prompted by last year's recall of infant formulas that were deficient in chloride.

✓ A Washington equal-employment-opportunity seminar held by the National Alliance of Business warned employers that "no matter how good their equal-employment record, they are likely to face a discrimination action in the near future." One speaker cautioned that an employer faces a one-in-three chance of being sued over the next three years if he has over a hundred employees.

✓ A General Accounting Office report has revealed that the Pentagon has lost more than a billion dollars in recent years by failing to charge foreign nations for the training and transportation costs associated with the purchase of American military equipment. For instance, the Army Tank Automotive Command billed foreign governments only $1.5 million for several contracts on which a total of $3.1 million was owed.

✓ The Supreme Court has ruled that the Environmental Protection Agency can enforce water-pollution standards regardless of whether a factory can afford the cost of compliance. This ruling rejects the contention of the coal and quarry industry that current cleanup rules should be relaxed for companies that cannot afford the expensive technology needed to clean up their wastes.

✓ Before adjourning, the 96th Congress authorized by a narrow margin a $1.6 billion "superfund" to clean up chemical wastes. Under the measure, the President may choose some one or two thousand abandoned chemical dumps for immediate cleanup. The bill also creates a new agency to keep track of diseases associated with toxic wastes and a $200 million fund to monitor the closed dumps.

✓ In keeping with the Christmas spirit, the last big appropriations bill of the 1980 Congress included such items as: (1) a $2.5 million amendment to build an access road to a Trident submarine base in Washington; (2) $2 million for the Department of Agriculture to destroy the Khapra beetle, a pest that has infected two spice factories in Baltimore; (3) $750,000 to fund a public-affairs teaching chair at Fisk University in Nashville; (4) Senate approval, sponsored by Harry F. Byrd (Ind-Va.), of language banning the use of any federal funds to assist anyone who advocates violent overthrow of the government; (5) approval of about $200 million for 36 construction and repair projects; and (6) $12 million for a courthouse in Redding, California.

✓ Small businesses and individuals who win court cases involving the federal government or a federal regulatory agency may now be reimbursed for attorneys' fees and other court costs. The new law is part of a program designed to encourage challenges to federal regulations.

✓ The Securities and Exchange Commission now has the power to obtain a federal court order to secure a person's bank records if such information is needed to investigate securities fraud. Although the SEC may seize the individual's records without warning, it must then notify the individual of the seizure to allow for a possible legal challenge.

✓ The Department of Agriculture is now planning to give farmers direct loans of up to $200,000 or loan guarantees of up to $300,000 to promote the use of solar energy, methane gas, or alcohol for use on the farm. In the past, such assistance was only available if the farmer used the energy to heat his home. ■

Rent Control (Cont. from p. 7)

This assault on housing is carried out in the name of preserving "natural ecosystems" and open space. In this assault the continued existence of a rare plant in its natural habitat is judged to be more significant than the provision of adequate housing to human beings; and the preservation of panoramic views commanded by people who already have elite homes in attractive locations is judged to be sufficient cause to prevent other people from moving into the area. It seems that backpackers so enjoy hiking through wilderness areas that they feel justified in forcing others to bear the burdens of their packs.

Whether antidevelopment people know it or not, the result of their actions is to raise the prices of all kinds of housing. Not even the Sierra Club can repeal the law of supply and demand. It is the poor, as always, who find price increases most burdensome. It is the

poor who are most hurt by the selfishness of the antidevelopment forces. Antidevelopment people who realize that they are hurting the poor try to shift the blame to speculators, and they recommend that the problem be solved by rent control. But rent control cannot help the poor. There simply is no solution to the problem of housing shortages other than the provision of additional housing.

Antidevelopment groups are typically made up mostly of upper-income elite people who have what they consider to be "the good life" and desire to protect it against any encroachment from "undesirables." For example:

> A recent survey of the Sierra Club membership showed that fully two-thirds of the main wage earners in members' households come from the following occupational groups: lawyers, doctors, dentists, other professionals, college teachers and other teachers, managers and executives, and engineers. More than half the members have had some post-graduate education, with 18 percent having a Ph.D., law, or medical degree, and 21 percent a Master's degree.[5]

Housing developments bring people of less august occupation and income levels, people who tend to lower the "social tone" of a community and who are likely to have children whose entry into the public school systems might increase tax burdens on the elite. Why should the elite have to pay for the education of the children of these outsiders? Their children are in private schools.

Some people whose motives are less socially acceptable than the stated motives of environmentalists use environmental protection as a cover. In Frieden's words:

> In political controversies the new concept of the environment has been able to absorb an earlier and more selfish agenda concerned with preserving the status quo against newcomers. During the suburban buildup of the 1950s, suburbs were already using their land development controls to keep out undesirables. The main fiscal undesirables then were families living in modest homes with young children whose education would use up property tax dollars. Other undesirables were . . . people whose occupation, income level, life-style, religion, or skin color might threaten the prestige levels established by earlier residents. Concern for the environment, as such, was not an important political factor in the 1950s. When this concern emerged later, it reinforced and provided cover for local groups more concerned with fiscal and social undesirables than with protection of wildlife.[6]

"It is the poor who are most hurt by the selfishness of the antidevelopment forces."

Friends of the Earth are not friends of the poor.

Helping the Poor without Rent Control

Much of the housing shortage that causes prices—both in rental housing and owner-occupied housing—to increase so dramatically is caused by regulations such as zoning, subdivision regulation, building codes, and permit delays. Limitation of development in the name of environmental and open-space preservation adds to the problem, and so, too, does the process of inflation. All of these sources of trouble involve direct government action. If the problem that has led to the current outcry for rent control is the effect on the poor of rising prices of housing services, at least a part of the solution would seem to be substantial reduction of the government actions that cause the price increases. Building codes ought to be revised so that they only protect the health and safety of building inhabitants. As it is now, they protect the interests of building trades unions. Zoning laws ought to be revised so that all they do is to separate incompatible land uses. As it is now they preserve the social tone of elite neighborhoods. The permit process ought to be speeded up by eliminating the opportunity for any special interest group to challenge developments and file appeal after appeal when they don't get their way. Environmental regulations ought to be revised so that the interests of humans are put ahead of plants, animals, and open space. It ought to be recognized that potential home buyers and apartment dwellers are people with rights that are just as important as the rights of those who like to backpack in wilderness areas. In short, some sense of balance ought to be introduced into the regulatory process.

Another measure that would be very effective in eliminating the problem that the rent control advocates say they are worried about is tax reform. Specifically, interest and dividend income ought to be exempt from taxation. Saving is the source of funds that investors use to build homes, construct factories, and to acquire machinery, equipment, and tools. More homes mean lower prices of housing services. More plant and equipment construction means more jobs for the poor. Saving is the source of real growth, and real economic growth is the only possible source of improved living standards for all people at the same time. If the economic pie is fixed in size, more for some people must mean less for others. If the pie gets bigger and bigger, it is possible for all to get more at the same time. The enemies of real economic growth are the true enemies of the poor. If the zero-growth advocates get their way, there will be more and more fighting over a pie that at best is fixed in size and probably is even shrinking.

If interest and dividend income were exempted from taxation, people would have more incentive to save than they do now. Current income tax laws bias the choices of people away from saving and toward consumption. To see why, consider the following example: In the absence of any income tax at all, it would take $1.00 of income to purchase a $1.00 consumption good, and it

would also take $1.00 of income to buy a $1.00 investment good. If the rate of interest is 10%, the $1.00 investment good would generate an interest income of 10 cents per year. Suppose now that a 20% income tax is imposed, and that interest income is taxed along with other income. In order to buy a $1.00 consumption good, it would be necessary to earn $1.25 of income before tax. In order to have 10 cents interest income after tax, it would be necessary to have 12.5 cents interest income before tax. It would be necessary to earn $1.56 of income before tax in order to have $1.25 after tax to use to purchase an investment good that yields a before-tax interest income of 12.5 cents. With the tax the price of a $1.00 consumption good is $1.25, but the price of a net interest income of 10 cents is $1.56. The cost of saving has risen relative to the cost of consumption, so less saving will be done relative to consumption.

If interest income were exempted from the tax, one would have to earn $1.25 of income before tax to purchase a $1.00 consumption good, and one would have to earn $1.25 of income before tax to be able to purchase a $1.00 investment good that would yield an interest income of 10 cents. The price of saving would be unchanged relative to the price of consumption; therefore, the tax would not reduce saving relative to consumption.

Deregulation and this type of tax reform have one overwhelming advantage over either rent vouchers or a cash subsidy plan: They do not involve taking income earned by one person and transferring it to another person. On the contrary, they let all people keep more of what they earn for their own uses. To the extent that such reform also produces sufficient economic growth to increase the purchasing power of the poor as much as subsidy plans would, it is unquestionably superior to either subsidy plan. Even if it doesn't increase the purchasing power of the poor as much as subsidy plans would, it has a lot to recommend it. Deregulation and the exemption of interest income, if implemented, would reduce the need for direct subsidies. These measures offer a clear opportunity to reduce the extent of coercion in the society while at the same time addressing the perennial question, What about the poor?

Conclusion

A rent control advocate is like Adam Smith's man of system who

> is apt to be very wise in his own conceit, and is often so enamored with the supposed beauty of his own ideal plan of government, that he cannot suffer the smallest deviation from any part of it. . . . He seems to imagine that he can arrange the different members of a great society with as much ease as the hand arranges the different pieces upon a chess-board; he does not consider that the pieces upon the chess-board have no other principle of motion besides that which the hand impresses upon them; but that, in the great chess-board of human society, every single piece has a principle of motion of its own, altogether different

INFLATION MONITOR

A quarterly feature of *Policy Report*, the "Inflation Monitor" shows the distorting effects on relative prices throughout the economy of government fiscal and monetary prices. All figures are expressed as annual rates of change, unless otherwise indicated.

	1980 Third Quarter	1980 Second Quarter	1980 First Quarter	Average for Last Four Quarters
MONETARY SECTOR				
Monetary Base	6.9	5.2	7.6	7.3
M1-A	11.0	−3.9	4.8	4.1
M2	15.4	5.5	7.2	8.8
M3	12.6	5.7	7.8	8.8
Discount Rate (average)	10.9	12.4	12.5	11.9
Prime Rate (average)	11.6	16.3	16.4	14.8
PRICE CHANGES				
Consumer Price Index	13.8	4.9	21.6	13.7
All-Finished-Goods Price Index	12.2	6.0	19.3	12.7
Intermediate-Materials Price Index	6.4	5.2	24.0	13.2
Capital-Equipment Price Index	8.5	11.3	13.4	10.8
INDUSTRIAL PRODUCTION INDICES				
Consumer Goods	142.9	143.3	148.3	146.1
Producers Goods	147.2	146.8	159.4	153.3
Raw Materials	139.0	145.0	156.3	149.2
Ratio of Capital Goods Production to Consumer Goods Production (1967 = 1.00)	1.03	1.02	1.07	1.05

SOURCE: *Federal Reserve Bulletin*

from that which the legislature might choose to impress upon it.[7]

If rent control advocates were really interested in the welfare of the poor rather than increasing the extent to which everybody (except them) is treated as a piece on a chessboard, they would be seeking ways of lowering the market prices of housing. Instead they seem to be aligned with the environmentalists and other zero-growth advocates in a battle against the economic system of private property and voluntary exchange. In spite of all the evidence that government is the problem, they advocate still more government action; and, sadly, it seems they always will. ■

[1] Gary S. Becker, *Economic Theory* (New York: Alfred A. Knopf, 1971), p. 108.

[2] Eric K. Hemel, "What Does Rent Control Control?" *Taxes and Spending* (San Francisco: Institute for Contemporary Studies), Fall 1979, p. 85.

[3] Ibid., p. 84.

[4] D. Gale Johnson, "Rent Control and the Distribution of Income," *American Economic Review*, May 1951, p. 582. Quoted by Edgar O. Olsen in "An Econometric Analysis of Rent Control," *Journal of Political Economy*, November-December 1972, p. 1099.

[5] Bernard J. Frieden, *The Environmental Protection Hustle* (Cambridge, Mass.: The MIT Press, 1979), p. 130.

[6] Ibid., p. 129.

[7] Adam Smith, *The Theory of Moral Sentiments* (1979), (Indianapolis: Liberty Classics, 1977), pp. 380–81.

PR *Reviews*

Cutting Back City Hall by Robert Poole, Jr. Universe Books, 1980. $12.50.

One of the most popular arguments against such tax-cutting measures as California's Proposition 13 is that state and local governments will be forced to cut back on "essential" services if their tax receipts are drastically reduced. Robert Poole's latest book, *Cutting Back City Hall*, convincingly refutes this myth by showing how many of these public services can actually be more efficiently provided by the private sector. Hence, not only are tax cuts desirable because they decrease the taxpayers' burden, but also because they provide a powerful impetus for privatization.

A persuasive example of Poole's thesis is his analysis and description of private fire protection. The largest of the agencies that fight fires for profit is the Rural/Metro Fire Department of Arizona. Rural/Metro, which has been in operation for over 30 years, now has more than 55,000 subscribers. While the average national household pays $103 a year in taxes for fire protection, the average Rural/Metro customer pays only $23 a year (less than one-fourth of the national average) and receives a higher quality of protection.

Poole's book is also chock-full of figures and facts on such issues as parks, libraries, garbage collection, police protection, and public education. The only flaw in his arguments is that he often suggests such arrangements as "user-fees" as ends in themselves, rather than as steps toward the ultimate goal of a completely free market. Only the abolition of all government monopolies can lead to the justice and prosperity of a free market.

The Full Employment Alternative by Andrew Levinson. Coward, McCann & Geoghegan, 1980. $10.95.

The thesis of *The Full Employment Alternative* is that the traditional approaches of liberals and conservatives to the unemployment problem have failed. The liberal attempts have failed because they accept the Phillips curve unemployment-vs.-inflation trade-off; the conservative proposals are bankrupt because they are "committed to a hopelessly outmoded laissez-faire philosophy." Levinson ridicules the economic theories (i.e., neoclassical economics) behind that philosophy because the theories are based on such unrealistic assumptions as perfect foresight for all economic actors. Such ideologies have resulted in the growth of a permanent class of unemployed citizens and in governmental reluctance to formulate policies to deal with unemployment. The author's suggestion for our problems is "a uniquely American coalition of business, labor, and government with a genuine commitment to full employment."

Unfortunately, Levinson does not discuss free-market solutions to the unemployment problem that do not rest upon neoclassical economic theory: The abolition of the minimum wage and the elimination of occupational licensure, for example, are given short shrift. Not only could the removal of such interventions solve many of the problems in our labor markets, but it is also consistent with individual freedom. The same cannot be said for Levinson's approach.

The Fleecing of America by Sen. William Proxmire. Houghton Mifflin, 1980. $10.95.

Senator Proxmire's latest book tells the story of the "Golden Fleece of the Month" award, an institution he established in 1975 to expose outrageous uses of taxpayers' money. The book, replete with examples, is a valuable survey of the waste and extravagance that have come to characterize the federal government. One particularly amusing example is a $97,000 grant given by the National Institute of Mental Health to study Peruvian brothels. The researcher, a Doctor Van den Berghe, defended the study by explaining its methodology: "Twenty-one prostitutes were formally interviewed and many more were interviewed informally. . . . By visiting the brothel at various times, it was possible to get a good idea of its everyday functioning."

The Fleecing of America contains chapters on such topics as New York City's fiscal problems and the Chrysler bailout. Proxmire argues that the poor are the primary victims of government handouts. Taxpayers with incomes of over $50,000 (only 1.5% of the population) actually get the benefits of over 75% of government-supported programs. ■

"To be governed..."

Balancing the budget

[Reagan's] administration-in-waiting, sprawling through nine floors of federal office space at 1726 M St. NW, has so many employees that no one can produce a definite count (estimates range from 588 to 1,200); . . . and it has spent so much money that a 50 percent cost overrun is predicted. . . .

As for the budget overrun, [transition financial controller Verne] Orr says he never expected to carry out the transfer of power for the $2 million Congress appropriated.

—*Washington Post*, Dec. 15, 1980

Rising above principle

Transportation Secretary-designate Drew Lewis yesterday promised less government involvement in transportation industries, but indicated there will be exceptions such as the ailing automobile industry. . . .

He said while the Reagan administration is committed philosophically to letting the free enterprise system work without government interference, it cannot let a major auto company go bankrupt "if there is a reasonable solution to it."

—*San Francisco Chronicle*, Jan. 8, 1981

Reflect on this

The public relations firm [of Deaver & Hannaford] is claiming the bounty of its close association with the president-elect—a stable of well-paying conservative clients who have made it one of the fastest-growing firms in the country. . . .

Among the firm's other large corporate clients are 3M Co. and Rockwell International. 3M has been trying to convince state officials in California for four years to adopt a proposal requiring use of reflective material in auto license plates. Such a law could mean $500,000 a year in revenues to 3M, but so far the idea has not been persuasive, despite the efforts of Deaver & Hannaford.

—*Washington Post*, Dec. 18, 1980

What a way to mismanage

The Air Force renegotiated a missile contract, raising it from 286 million dollars to 430 million, following what the appropriations panel called "gross mismanagement" by the contractor.

—*U.S. News & World Report*, Dec. 8, 1980

Room for one more?

In New Jersey, it's called the Politicians' Full Employment Act. In truth, it is a state law, passed earlier in 1980, that allows public financing of gubernatorial primaries. . . . A candidate needs just $50,000 to start drawing the state's matching funds, which is not especially hard. Hence the rush to become Governor is on; 18 people have already declared that they will run in next June's primary. Others will soon join them.

—*New York Times*, Dec. 30, 1980

Our new ZIP code

What this boils down to is a system that will require an individual to call a ten-digit number to get the correct nine-digit number that must be placed on the letter to replace the five-digit number. However, if people can't remember the ten-digit number that must be called, they can always dial a three-digit number, 411, to find out how to get the ten-digit number so they can call to get the nine-digit number to replace the five-digit number.

—Sen. Roger Jepsen (R-Iowa), before the Subcommittee on Energy, Nuclear Proliferation, and Federal Services, Nov. 25, 1980

A new twist for imports

Maryland, the District and West Virginia yesterday accused Mid-Atlantic Toyota Distributors Inc. of Glen Burnie and approximately three dozen regional Toyota dealers with conspiring to artificially *inflate* the price of cars by an estimated $500 each since late 1979.

—*Washington Post*, Dec. 19, 1980

We could have told you that—in fact we did!

Antonio Cabral, a provincial director of agriculture, has come to Moamba, Mozambique, to deliver a stunning message. Central planning, the soul of a socialist economy such as Mozambique's, "hasn't functioned at all" on the farm, he says.

—*Wall Street Journal*, Dec. 30, 1980

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CONTACT: David Boaz
Chris Hutmacher
(415) 433-4316

NEW STUDY OFFERS BETTER WAY TO PREDICT ELECTION RESULTS

SAN FRANCISCO, August 24, 1981 -- Election analysts must recognize that there are not two but four distinct ideological groupings in the American electorate, according to a study just released by the Cato Institute.

Political scientists Stuart A. Lilie and William S. Maddox, opinion-survey experts at the University of Central Florida, argue that the liberal-conservative dimension must be expanded to reflect four basic belief systems prevalent among the public. They designate those positions as liberal, conservative, populist, and libertarian. Populists are the largest group, comprising 24 percent of the electorate. Conservatives comprise 18 percent; liberals, 16 percent; and libertarians, 13 percent. (Divided, centrist, and inattentive respondents account for the remaining percentage.)

Lilie and Maddox describe the positions of the four groups as follows: "The liberal supports government intervention in economic affairs and the expansion of individual (civil) liberties; the conservative opposes both. The libertarian supports expanded individual liberties but opposes economic intervention. The populist supports economic intervention but opposes expansion of individual liberties."

Traditionally, Lilie and Maddox explain, political scientists have evaluated ideological thinking among the public only in terms of the liberal-conservative dimension. "Thus respondents whose attitudes do not fit the researcher's definition of liberal or conservative are categorized as nonideological or

(more)

inconsistent. This approach of course assumes that liberal and conservative are the most meaningful and logical positions for a person to take. In recent years, however, researchers have become uncomfortable with this unidimensional approach."

In revising this traditional approach, Lilie and Maddox took the data collected by the 1976 Center for Political Studies Election Survey and analyzed it in a different way. Taking three economic questions and three civil-liberties questions, they classified each respondent as being in favor of or opposed to government intervention in the economy and in favor of or opposed to the expansion of individual liberties. Then they combined the two major issue dimensions into four categories to describe more precisely the ideological orientation of the public.

Besides coming up with the overall percentages cited above, they also analyzed the demographic characteristics of each group. For instance, populists predominate at the lowest income level in the sample, while libertarians are more heavily represented in upper income groups. At the lowest education levels, populists and conservatives dominate (reflecting an agreement that civil liberties should not be expanded but a disagreement over economic questions), while liberals and libertarians are the largest groups among college graduates (reflecting an agreement that civil liberties _should_ be expanded but again a disagreement over economic issues). Liberals and libertarians are strongest among the youngest age groups, while populists and conservatives dominate among older respondents. Libertarians are strongest in the West and weakest in the South, while populists reflect just the opposite geographical distribution.

Questioning why political scientists have continued to use the one-dimensional liberal-conservative approach when it has obvious disadvantages, Lilie and Maddox offer a partial answer. First, they point out that many researchers assume that liberal and conservative define the conflicts in American politics. It is the basic division within institutions like Congress and is therefore most relevant for voters as well. If voters hold other ideological positions, they are largely

irrelevant to the political system. But in fact, when analyzing even elites like Congress, the liberal-conservative continuum must often be discarded or modified. Second, the authors say, a major reason for continued use of the liberal-conservative approach is its methodological simplicity. They suggest that both these factors are reflected by the authors of a recent article, who conclude that it is necessary to analyze issue consistency on a liberal-conservative scale so that "electoral mandates could be easily interpreted."

However, Lilie and Maddox conclude, "By clarifying the liberal and conservative labels and adding two new categories we are able to more completely explain the behavior of the American electorate. . . . We find tendencies for our four groups to behave differently (even after controlling for various demographic factors) in such areas as party identification, presidential vote, and evaluation of candidates' issue positions. Further, we can speculate that the existence of two major groups of people who hold political beliefs for which the traditional language and labels of American politics provide more confusion than clarity has long-range implications for the political system.

"(Contemporary political changes) may also be related to the presence of two ideological groups in society whose belief systems are not reflected by the Democratic or the Republican party nor by their candidates.

"If our analysis is correct, the major parties and their candidates will have to deal with the presence of at least four, rather than two, ideological groupings in the American electorate. And those who seek to predict or explain voter behavior including voter apathy will especially have to recognize these four distinct groups."

An earlier version of this paper was presented at the annual meeting of the Midwest Political Science Association, Chicago, Illinois, April 1979. Copies of the study, part of the Cato Institute's Policy Analysis series, are available from the Institute.

CATO INSTITUTE POLICY ANALYSIS

August 24, 1981

AN ALTERNATIVE ANALYSIS OF MASS BELIEF SYSTEMS: LIBERAL, CONSERVATIVE, POPULIST, AND LIBERTARIAN

by Stuart A. Lilie and William S. Maddox

Summary

This study, based on the 1976 Center for Political Studies Election Study, suggests that at least four different belief systems exist among the American public. We treat the dimension of government intervention in economic affairs as distinct from the dimension of expansion of individual liberties. The liberal supports government economic intervention and the expansion of individual liberties; the conservative opposes both. The libertarian supports expanded individual liberties but opposes economic intervention. The populist supports economic intervention but opposes expansion of individual liberties. Some 72.4 percent of the sample can be classified as holding consistent or nearly consistent political beliefs using these categories. The relationships between our ideological categories and demographic groupings are generally consistent with expectations about these groups. We also explore the relationships between our classifications and ideological self-identification, party identification, and presidential vote.

Stuart A. Lilie is an associate professor in, and the chairperson of, the Department of Political Science at the University of Central Florida, Orlando 32816. William S. Maddox is also an associate professor in that department, and for 1981-82 he is a visiting assistant professor in the Department of Political Science at the University of New Orleans, Louisiana 70122.

An earlier version of this paper was presented at the annual meeting of the Midwest Political Science Association, Chicago, Illinois, April 1979.

Political scientists use a variety of methods to measure the presence and direction of ideological thinking among mass publics. A standard approach is to code responses to open-ended "like and dislike" questions about candidates and parties according to ideological content. (1) Another method is to use correlations across issues positions (2) or across issue clusters. (3) Pierce (1970) added what he called the informational and affective dimensions of ideology, based on definitional questions about ideology and feeling thermometer reactions to the terms liberal and conservative. (4) Several studies use factor analysis to determine the number and nature of issue dimensions that are necessary to structure opinions in both masses and elites. (5) Finally, the ideological self-identification of respondents, often included in studies of particular elections, (6) has recently received attention as an independent predictor of presidential voting. (7)

Despite the great variety of techniques, all these studies share a common approach; a single liberal-conservative dimension is the primary tool for evaluating the presence and direction of ideological thinking among mass publics. Thus respondents whose attitudes do not fit the researcher's definition of liberal or conservative are categorized as nonideological or inconsistent. This approach of course assumes that liberal and conservative are the most meaningful and logical positions for a person to take. In recent years, however, researchers have become uncomfortable with this unidimensional approach, as is indicated by various caveats and disclaimers. For example, LeBlanc and Merrin admit that "there is no logical reason why voters could not be liberal on some issues and center or conservative on others," (8) while Nie, Verba, and Petrocik conclude that those whom they classify as inconsistent may be "consistent in ways we do not recognize." (9)

In spite of these caveats, analysts of mass belief systems continue to use a liberal-conservative continuum in their research. We contend that there are empirical and theoretical reasons to go beyond this unidimensional approach. Many of those respondents who are currently labeled "inconsistent" may in fact

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(1) Campbell et al. 1960, Converse 1964, Field and Anderson 1969, Pierce 1970.

(2) Converse 1964, Nie and Anderson 1974.

(3) Stimson 1975, Kritzer 1978.

(4) These were also used by Holm and Robinson 1978 in a different context.

(5) Luttbeg 1968, Stimson 1975, and Kritzer 1978.

(6) Converse et al. 1965, Converse et al. 1969, Miller and Miller 1975, and Miller 1978, for example.

(7) Holm and Robinson 1978, Levitan and Miller 1979.

(8) LeBlanc and Merrin 1979, p. 61.

(9) Nie, Verba, and Petrocik 1976, p. 138.

be consistent on other dimensions as significant as the present liberal-conservative continuum. By extending and refining ideological categories, we will more adequately understand the belief systems of the American electorate.

To achieve this end, we propose a two-dimensional approach as the basis for the analysis of mass belief systems. We measure attitudes toward economic intervention by government and attitudes toward economic intervention by government and attitudes toward individual liberties as separate dimensions and consider four ideological categories based on these two dimensions: liberal, conservative, libertarian and populist. Our definitions of liberal and conservative are generally consistent with current practice; there are also, we will argue, valid grounds for including the categories of libertarian and populist. Our approach, then, is an outgrowth and complement to current research in that it includes the liberal and conservative categories as traditionally defined, but attempts to account for many of those others who are "consistent in ways we do not recognize." Before developing specific definitions and categories, we will examine three arguments in support of the use of a two-dimensional approach to contemporary ideologies. (10)

First, among public-opinion researchers, as a recent writer notes, there is "an observation of great vintage: the content of mass political policy preferences is multidimensional...." (11) The origin of this recognition is the work in the fifties by Stouffer (1955) and Lipset (1959), which showed that working-class individuals are more "liberal" on economic issues but less "liberal" with respect to civil-liberties issues. Since then the nature of these dimensions and their relationship to social and economic status have been amplified and refined by many writers, including some who argue that this classic relationship is becoming inverted. (12)

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(10) The work of Milton Rokeach (1973) is an interesting exception to this reliance on a single continuum. He suggests that liberalism-conservatism is not a bipolar ideology, but must be considered as having two dimensions -- attitudes toward freedom and attitudes toward equality. This approach has value when analyzing competing ideologies from a global perspective, but as Rokeach himself says, its usefulness is limited in a given political system where there is a high degree of consensus, as in the United States, where certain basic freedoms are highly valued by almost everyone. Our proposal is a two-dimensional approach that clarifies ideological differences on economic and individual liberties issues, recognizing that these differences are relatively subtle because they largely fall within the parameters of the American consensus on these issues.

(11) Knoke 1979, p. 772.

(12) Ladd and Hadley 1978. For a summary of this literature and a multivariate analysis of this relationship, see Knoke 1979.

More recently, studies using factor analysis have also identified a number of separate dimensions in mass attitudes, including separate economic and social dimensions. (13) While the existence of these two dimensions is now an observation "of great vintage," little has been done to develop the full implications of this observation for categorizing individuals as liberal or conservative.

A second body of literature that demonstrates the inadequacies of a unidimensional approach is elite studies. For example, in his analysis of the Supreme Court, Schubert (1965) scaled liberalism into two basic dimensions, political and economic. He defined political liberalism in terms of "claims and personal (as distinguished from property) rights and freedoms" (p. 101) and economic liberalism as relating to "conflicts of interest between the economically affluent and the economically underprivileged" (p. 128). Schubert's analysis of the components of ideology is more sophisticated than that used here, but his work demonstrates the inadequacy of unidimensional definitions of liberalism and conservatism in elite analysis and again suggests that the two basic dimensions of ideology are economic issues and questions of personal liberty. Students of the U.S. Congress have found that while congressional roll-call votes show party as a strong predictive variable, a number of other dimensions are significant in explaining divisions in legislative votes, including several "policy domains" or "issue sets." (14) One student of Congress concludes that "different alignments form as the policy content changes . . . liberal and conservative ideologies do not provide the bases for many, many policy decisions." (15) Thus analyses of two significant segments of political elites, the Supreme Court and the Congress, call into question the assumption that elites rely simply on a liberal-conservative continuum in their decision making.

A third reason for going beyond an unidimensional approach in the study of mass belief systems is that liberal and conservative are not the straightforward terms they are often assumed to be. While early-nineteenth-century liberal thought emphasized the expansion of individual liberties, including the absence of government intrusion in economic choices, by the late nineteenth century debate over the relationship of liberty and equality often focused on the proper role of government in acting to alleviate the perceived hardships of a capitalist economy. Indeed, the connection between government's economic role on the

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(13) Miller and Miller 1975, Stimson 1975, Pomper 1975, for example.

(14) Turner 1951; MacRae 1958; Truman 1959; Mayhew 1966.

(15) Clausen 1973, p. 31.

one hand, and individual liberties on the other hand, has been the crux of much of the ideological debate in recent Anglo-American thought. Traditional theory provides no logically necessary reason to place attitudes about economic issues on the same dimension as attitudes about individual liberties. In fact, to do so obscures much of the theoretical debate of the past one hundred years.

If the advantages of supplements to the liberal-conservative continuum are so obvious, why has a unidimensional approach persisted? This question deserves more extended treatment, but two factors are notable here. One is the assumption by many researchers that liberal and conservative define the context of American politics. It is the basic division among elites and is therefore the relevant continuum for the voter. If mass publics hold other ideological positions, these are largely irrelevant to the dynamics of the political system. However, while it is true that political elites and the media use liberal-conservative terminology, scholars have found, as we have indicated, that close analysis of elite behavior often requires that they discard or modify the liberal-conservative continuum. A second factor is the methodological simplicity of a unidimensional approach. Conceptualization, question and scale construction, statistical analysis, and even graphic representation of data are simplified when working with a single dimension. Perhaps both these factors are reflected by the authors of a recent article, who conclude that it is necessary to analyze issue consistency on a liberal-conservative scale so that "electoral mandates could be easily interpreted." (16)

Empirical Definition of Belief Systems

Taken together, these three arguments provide theoretical and empirical bases for going beyond the traditional liberal-conservative dimension in the analysis of mass belief systems. They also suggest that the question of government intervention in the economy is separable from the question of individual liberties. To operationalize these two dimensions with available survey data, we selected three issue questions for each dimension from the 1976 Center for Political Studies Election Survey. As other political scientists have done, we selected issues that appear to represent each dimension; (17) we also found some empirical support for our selection of issues. The respondents in the survey tended to treat these issues as representative of distinct dimensions, as indicated by a statistical technique called factor analysis. Factor analysis identifies types of issue questions to which people responded in similar ways.

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(16) LeBlanc and Merrin 1979, p. 61.
(17) See, for example, Knoke 1979.

We performed a factor analysis with varimax rotation of twenty-five issue questions. This analysis revealed eight factors, of which two explained a total of 60.7 percent of the variance. The two dimensions used here are defined by the three issues with highest loadings on those two factors that were the issue questions we originally chose. Factor I, economic intervention, is represented by government guarantee of jobs (with a loading of .57), government health insurance (.43), and progressive taxation (.39). Factor II, individual liberties, is represented by legalization of marijuana (.54), abortion (.43), and equal role for women (.33).

We combine the two major issue dimensions into a fourfold typology, which we use to approach the ideological orientation of the public. Perhaps the most straightforward of our four types is the <u>libertarian</u> who opposes government intervention but supports a high degree of individual liberties. This is the classical liberal position of the nineteenth century, represented by such figures as the early John Stuart Mill and (in extreme form) by Herbert Spencer. Because the mainstream of contemporary liberal thought has moved away from this position, it is confusing to label it liberal. However, the term libertarian is generally used today to describe this position. The libertarian position has recently received attention through the efforts of the Libertarian party (their 1980 presidential candidate received 1.1 percent of the popular vote). In the latter part of the nineteenth century such liberals as the later J. S. Mill and T. H. Green argued that if the liberal goal of promoting the independence and well-being of the individual were to be achieved, opposition to all forms of government economic intervention must be modified. Thus the state should take some responsibility for individual welfare through such measures as wage and hour laws, compulsory public education, and health and safety regulations. At the same time, liberals continued to support such personal liberties as freedom of speech and conscience. This position, sometimes called "welfare state liberalism" (although for obvious reasons liberals in the United States rarely use this term), is generally what is meant by liberalism in contemporary usage. Thus in terms of our two dimensions the <u>liberal</u> supports government intervention but also supports an expansion of individual liberties. On the other hand the <u>conservative</u> position as it has developed in the United States has been that human nature is sufficiently deficient that, without constraints imposed by society, the individual is likely to behave in deviant and socially harmful ways. Thus some restrictions on individual liberties are in principle desirable. In addition, American conservatives argue that in the economic realm, perhaps again because of man's selfish nature, the workings of the market should be relatively free from government intervention, in order to be efficient and productive. In terms of our two dimensions, the conservative supports restrictions on personal liberties but opposes government economic intervention. Finally the <u>populist</u>, while sharing the moralism of the conservative in regard to individual liberties, feels that an

unregulated economy often means an unfair concentration of wealth at the expense of the poor. Thus the populist, while opposed to the expansion of individual liberties, does support government economic intervention.

Following earlier researchers, we recode the answers to each of the six questions (government guarantee of jobs, government health insurance, progressive taxation, legalization of marijuana, abortion, and equal role for women) into three categories: support, opposition, and centrist. A consistent liberal supports government action on all three economic issues and supports expansion of individual liberties on all three of those issues; the consistent conservative takes the opposite position on all six issues. The consistent libertarian opposes all three government actions in economic affairs and supports all three individual-liberty proposals. The consistent populist supports all three economic interventions but opposes all three of the expansions of individual liberties.

Because of the complex nature of our measure, only respondents who expressed an attitude on four or more of the six issues (90 percent of the sample) are considered for classification as consistent, although the percentages of all tables are based on the total sample. Our findings support the earlier conclusions that perfect consistency is rare in the American public; the proportion we find as consistent (7.3 percent of the sample) is lower than the 17.8 percent found by LeBlanc and Merrin (1977), probably because our definition of consistency involves two dimensions.

LeBlanc and Merrin suggest that to measure perfect consistency is "too stringent a test" and use the term "nearly consistent" for those who deviate from consistency on only one issue or whose attitudes include liberal and centrist or conservative and centrist positions. (18) We follow the same strategy and define the "nearly consistent" as those in each category who are inconsistent on only one issue on each dimension. The nearly consistent populist, for example, takes the populist position on at least two of three economic intervention issues <u>and</u> on at least two of the three individual-liberties issues. The "deviant" attitudes may be a response in the nonpopulist direction, a centrist response, or no response at all. Table 1 presents the distribution of the totally consistent ideologues, the nearly consistent, and the results of combining the consistent with the nearly consistent respondents.

We find that 72.6 percent of the sample can be classified as consistent or nearly consistent. The "traditional ideologies" of liberal and conservative do not appear to explain more belief

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(18) LeBlanc and Merrin 1977, pp. 1063-64.

Table 1

Attitude Consistency in the American Public: 1976

Totally Consistent		
Libertarian	.7	
Liberal	2.4	
Center	0.0	
Conservative	1.5	
Populist	2.7	
		7.3
Nearly consistent		
Libertarian	12.4	
Liberal	14.0	
Center	1.6	
Conservative	16.4	
Populist	20.9	
		65.3
Divided		17.6
Hold fewer than 4 of 6 attitudes (inattentive)		9.8
		100.0
Summary		
Populist		23.6
Conservative		17.9
Divided		17.6
Liberal		16.4
Libertarian		13.1
Inattentive		9.8
Center		1.6
		100.0

NOTE: The data in this table and those that follow were made available by the Inter-University Consortium for Political Research. Neither the Center for Political Studies nor the consortium bears any responsibility for the analysis or interpretation presented here.

systems than do the two additional orientations. The populist group is the largest, followed by the conservatives, liberals, and libertarians. Many of the "inconsistents" so long lumped together as a group in fact can be classified according to belief systems measured by a more complex standard than that used to identify only liberals and conservatives in previous research. Rather than a mass public consisting of a few ideologues and many inconsistents, we find a much more divided and diverse public.

Although LeBlanc and Merrin (1977) found that attitude consistency was related to expressing fewer attitudes, we find that this is true only for the populist group, whose proportion of the sample declines from 58.6 percent of those holding only four attitudes to 16 percent of those expressing six attitudes. For the other three ideological groupings, however, the reverse is true. Their representation is actually greater among those who express more attitudes. (19) Note, however, that all respondents categorized as holding a type of belief system expressed opinions on at least four of the six issues.

Social Groups and Belief Systems

Table 2 summarizes a demographic analysis of our four types of ideologues. In general, the demographics reflect the scholarly and practical assumptions about the relationship of belief systems and social groups. Of particular note are the relationships of our categories to income, education, age, and region. Analysis of place of residence, length of residence, religion, union membership, sex, and subjective social class revealed few differences between ideological types.

Income. Predictably there is a strong relationship between income and ideological type. The populist category virtually preempts the other ideologies in the lowest income category and is barely found in the highest income group. Part of this tendency may be explained by the dominance of populism among nonwhites, who also make up much of the lower income categories. The libertarian category is the largest for the two highest income groups, representing 33 percent of those with an income of $35,000 and over. Distinctions that might be overlooked or obscured with a liberal-conservative continuum are obvious in this table. For example, the high proportion of libertarians among the wealthy may in part explain the "inversion" of the class base of liberalism and conservatism analyzed by Ladd and Hadley (1978). Many of the issues that Ladd and Hadley use to indicate that upper income strata are becoming more liberal are in fact issues of individual liberty -- abortion, marijuana, and sexual relationships, for example.

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(19) Data analysis relevant to this point is not presented here, as it is not our major concern. This information is available on request from the authors.

Table 2

Demographic Characteristics of Ideological Types*

	Populist	Conservative	Liberal	Libertarian	Divided
National	24%	18%	16%	13%	18%
(N)	(565)	(425)	(392)	(313)	(442)
Income					
0-5,000	43	9	10	6	12
5-10,000	29	15	18	9	19
10-15,000	21	21	17	12	20
15-20,000	15	23	18	17	21
20-25,000	12	24	18	15	26
25-35,000	9	23	21	30	14
35 & Above	7	22	15	33	18
Race					
White	22	19	15	14	19
Nonwhite	38	4	25	4	11
Education					
Grade School	43	15	7	3	9
High School	27	19	13	11	20
Some College	12	18	23	19	23
College Degree	8	17	30	20	20
Advanced Degree	8	17	26	33	13
Age					
18-25	17	10	27	21	19
26-30	17	16	24	15	18
31-35	16	18	18	16	22
36 & Over	28	20	11	10	18
Region					
Northeast	25	14	21	12	19
Midwest	22	22	14	15	19
South	29	17	12	9	15
West	14	16	22	17	23
Ideological Self-Classification**					
Liberal	11	6	43	18	16
Moderate	20	27	23	34	34
Conservative	22	44	13	37	29
No Answer	47	23	20	11	21

* Percentages add across the rows except where noted (**). Inattentives and the small centrist categories are not listed here. Therefore, the percentages add up to less than 100 percent.

** Percentages add down the columns.

Education. As can be seen from table 2, education relates strongly to ideological type. The most obvious relationship is the predominance of the populist category among those with grade-school and high-school education, and the relatively small percentage of populists beyond high school. Conservatives are drawn about equally from each of the educational groups, while the proportions of liberals and libertarians increase quite significantly with higher levels of education. For those with college and advanced degrees, these two types represent about half the group.

Age. The data show interesting generational differences. If we look at the period in which people in each age category reached political maturity, the differences may be explained in terms of the political "milieu" of the time. Among the oldest group, many of whom matured during the depression, the predominant categories are populist and conservative. This reflects the New Deal conflicts, which were primarily about questions of government intervention; the expansion of individual liberties was not a primary division.

The second age group came to political maturity in the late fifties, often characterized as the period of "the end of ideology." People in this age group are clustered remarkably close together -- our four ideological categories are within 5 percent of each other in size. The next age group matured during the early sixties, a period symbolized by John Kennedy and a liberal sense of confidence and mission. This age group is distinguished by a greater number of liberals than the older groups, with the other ideological categories remaining about the same size.

Our youngest group reached maturity in the mid-seventies, with a general disillusionment with government, but also an increased concern with the "social issues" that relate to the individual-liberties dimension. This younger group seems to be distinguished by a commitment to individual liberties in that the two largest categories are liberal and libertarian. Thus this youngest group is divided over the effectiveness of government economic intervention, but not over a commitment to individual liberties, whereas the oldest group is divided over government intervention but is in agreement that individual liberties should not expand.

Region. As one would expect, given the historical and economic factors in Southern politics, Southerners are more heavily populist than any other category, with conservative being the second largest category for that region. The South has few liberals or libertarians. In the Midwest, conservatism is represented equally with populism while in the Northeast populism is the largest category with liberalism a close second. Perhaps the most interesting region is the West, which consists mostly of California residents in this sample. Here the largest category

is the divided one, and no ideological category stands out as particularly large. The difficulty of building a coalition here is obvious. Some of the more bizarre aspects of California politics may reflect this lack of ideological agreement in the region.

The Political Behavior of Ideological Types in 1976

As Stimson (1975) argued, the identification of types of belief systems should be supplemented by a discussion of the behavior of those types of citizens. Do they behave in patterns that indicate that the belief system is in some way useful to them? Can we make predictions about the behavior of those in different belief categories? With the fourfold classification we have presented, these questions become even more complex. While the political world may be relatively well defined for liberals and conservatives, populists and libertarians may find the definition of American politics provided by the media more difficult to match with their own perspectives. We examine how these four types of ideologues respond to four major political choices: the liberal-conservative continuum as a means of self-classification, party identification, presidential vote, and the evaluation of political candidates.

Ideological Self-Classification. The comparison of the four ideological groups' responses to the liberal-conservative self-placement scale (trichotomized with the no-answer group presented separately) is at the bottom of table 2. The figures here add down the columns: We are interested in how members of each group classify themselves. The results generally confirm expectations. Almost the same proportion of liberals and conservatives correctly label themselves on this scale. In both cases about one-quarter choose to take the moderate way out, thus avoiding either of the two extreme labels. However, we cannot expect a perfect correspondence between classification based on issue positions and self-classification. (20) Just because a respondent holds a set of attitudes that analysis would describe as liberal, for example, does not mean that he understands the accepted definitions of that term or that he himself uses the same definition. Furthermore, in responding to the liberal-conservative scale, the person may be reacting more to the label and its connotations than to its representation of a set of issue positions. Some liberals, for example, may not wish to use the label (as in the 1976 campaign, when some liberal candidates for president suddenly became "progressive") because of negative connotations of big government and wasteful spending. Furthermore, Holm and Robinson suggest that some people in fact have an ideological framework for understanding politics but are not conscious of it. (21) The liberals and conservatives found here who choose the moderate or no-response option may be such people.

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(20) See Free and Cantril 1967.
(21) Holm and Robinson 1978, p. 237.

Self-classification is impossible for almost half of the populists; they have no obvious alternatives. Of those populists who do choose a label, almost four times as many choose either conservative or moderate as choose liberal, perhaps reflecting a hostility to the connotations of that term, despite the fact that they support major liberal economic initiatives. Libertarians do make a choice; their 11 percent nonresponse is the lowest of any group (probably reflecting their higher education levels). Furthermore, they are more likely to choose conservative (37 percent) or moderate (34 percent) rather than liberal as their label. Perhaps the word "liberal" for populists too strongly suggests changing social values or welfare spending. "Liberal" may remind libertarians chiefly of government spending and increased taxation.

Party Identification. Table 3 presents evidence on the partisan choice of the four major belief systems. Again, the percentages add down, indicating the distribution of each ideological group across the three partisan choices. Libertarians are the group most likely to be independent of the parties. Some libertarians may reason that Republicans are the most likely to minimize government economic intervention and yet not drastically alter the state of individual liberties. Others, particularly the large group of younger libertarians, may reason that both parties are capable of deficit spending and increased government activity, but the Democrats are closer to their position on questions of individual liberties and changing lifestyles.

The strong Democratic identification among populists (47 percent) may reflect the appeal of Democratic candidates -- for example, Jimmmy Carter in his support of economic intervention for the disadvantaged combined with lukewarm support for liberalization of individual liberties; or George Wallace, the candidate most often labeled a populist in recent years. Further, the endurance of party identification from its early formation and the fact that party identification may lag behind changing issue attitudes and realignments (22) suggests that populists, who may have formed partisan ties with the Democrats in earlier years when divisive social issues were not present (see our earlier discussion of age), should choose Democratic affiliation most often. The strength of candidates like Carter and Wallace in the presidential primaries of recent years is certainly not surprising given this finding. We must not overlook the substantial number of populists who call themselves independent and Republican, however. For someone with a populist set of issue positions, the choice between the two parties is a difficult one to make.

Liberals also are strongly Democratic (47 percent), but nearly as many identify themselves as independent. The conservative group is most evenly split across partisan choices, although the

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(22) See Ladd and Hadley 1973, for example.

Table 3

Relationship of Ideological Type to Party Identification, Controlling for Education, Income, and Race

	Libertarian	Conservative	Liberal	Populist
(N)	(313)	(425)	(392)	(565)
Party Identification				
Democrat	23	31	47	47
Independent	42	32	41	30
Republican	35	36	12	21
Grade School	(16)	(56)	(25)	(163)
Democrat	20	39	62	60
Independent	40	21	14	19
Republican	40	37	14	18
High School	(129)	(220)	(153)	(318)
Democrat	25	38	50	45
Independent	45	30	41	35
Republican	30	31	9	19
College	(175)	(147)	(215)	(83)
Democrat	21	16	43	30
Independent	40	40	44	34
Republican	38	45	13	34
Low Income	(69)	(108)	(133)	(327)
Democrat	37	41	53	53
Independent	41	21	35	25
Republican	23	37	12	20
High Income	(232)	(294)	(235)	(205)
Democrat	20	28	45	37
Independent	41	38	42	39
Republican	39	34	12	22
Whites	(298)	(408)	(321)	(457)
Democrat	21	30	42	42
Independent	43	32	44	31
Republican	36	38	14	25

Republicans are strongest. The failure of Republicans to tap their "natural constituency" is indicated by the one-third of the conservatives who choose the independent label and the one-third who choose the Democratic party.

The relationship between ideological views and partisan identification may be contaminated by demographic factors, however. While there are some demographic differences in the degree to which ideological types identify with the parties or remain independent, we find in table 3 that the same pattern exists for most demographic categories. First, Democrats in the total sample are the strongest among liberals and populists; they are less well represented among conservatives and do poorly among libertarians. That same pattern exists among Democrats with grade-school or high-school education, among both Democratic income groups, and among white Democrats. Only when we compare ideologues among Democrats with college education do we find a slight variation. Democrats are stronger among libertarians than among conservatives, but, even there, liberals include more Democrats than does the populist group, and the populist group in turn is more Democratic than the two remaining groups. Secondly, independents in the total sample are strongest among libertarians and liberals, followed by conservatives and populists; subgroups of independents show some variations from this pattern. Among the lowest education group of independents, all types are noticeably weaker except the libertarians. Among the high school educated group and those with low incomes, populists are stronger than conservatives among independents, but otherwise the national pattern is repeated. Among independents with college education, the liberals, libertarians, and conservatives are virtually even, and in the high income group all four types are virtually even. Finally, Republicans are most strongly represented in the conservative and libertarian groupings in the total sample, followed by populists and liberals last. For all of the control groups except one, this same pattern is replicated. Among the high income segment, Republicans are slightly more represented among libertarians than among conservatives, but generally speaking the relationship between ideological orientation and Republican identification holds constant even when controlling for demographic factors.

Presidential Voting. In the 1976 election, most voters perceived Carter as a liberal and Ford as a conservative. (23) To the extent that liberals and conservatives share the majority perception they should have been able to make a clear choice. For populists and libertarians the problem was not just that the two candidates did not reflect their views on major issue dimensions but that the definition of the candidates was generally in liberal-conservative terms. Populists, however, could have

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(23) Miller 1978.

responded to Carter because he de-emphasized lifestyle issues and focused on economic issues and trust in government. (As Miller 1978 points out, Carter tended to defuse those issues that had divided the Democrats in 1972.) Their tendencies toward Democratic identification obviously would have propelled many into Carter's column. For libertarians, many of whom are independents, the presidential choice was between two candidates whose pronouncements on questions of individual liberties did not greatly differ, although Carter probably more clearly supported women's rights and showed less enthusiasm for a "hard line" against legalization of marijuana and abortion. On the other hand, libertarians may have found Betty Ford's feminism and tolerance of changing lifestyles more appealing than Carter's Southern Baptist image. On the economic dimensions, however, Ford obviously opposed government intervention more than did Carter, whose campaign return to traditional Democratic liberalism may have muted his "un-Democratic" conservative economic views, which were noticeable earlier in the year. Thus a choice for Ford would have been the most defensible for the libertarian voter in 1976.

The proportion voting for Carter presented in table 4 indicates that our expectations are borne out. Sixty-six percent of liberals voted for Carter, slightly ahead of the 59 percent given him by populists. Conservatives gave him only 32 percent of their votes and libertarians supported Carter even less. The support for Carter among "self-identified" liberals is higher (79 percent) than the Carter support among the liberals as we have defined them. Similarly, the Ford vote among self-identified conservatives is higher than any conservatives as defined by our two-dimensional typology. We do not see this as a refutation of our classification, however. Those classified as liberals or conservatives in our method face a much more stringent test of classification than those classified by self-identification. Furthermore, the vote of "liberals for Carter" and "conservatives for Ford" by self-classification may mean little more than voter response to ideological labels that are repeatedly presented to them throughout a campaign, as both Field and Anderson (1969) and Pierce (1970) suggest happened during the 1964 campaign. Finally, our fourfold classification allows us to make predictions about two other groups, populists and libertarians, that are for the most part buried in the mountain of moderates and don't-knows of the self-classification scale.

We do not claim that membership in one of these ideological groupings is by itself the best predictor of a presidential vote. We suggest that a person's belief system may in some cases operate in conjunction with his partisanship to reinforce voting decisions or, in other cases, lead to defection. Further, the belief system should serve as a good predictor of presidential vote among self-identified independents. For evidence on this point, the lower part of table 4 presents the percentage voting for Carter in each ideological group while controlling for identification. As we expect, there are clear

Table 4

Relationship of Ideological Type and Vote for Carter
Controlling for Education, Income, and Race

	Libertarian	Conservative	Liberal	Populist
Vote for Carter	30%	33%	66%	59%
By Party Identification				
Democrat	61 (52)	71 (105)	85 (143)	84 (176)
Independent	30 (91)	29 (94)	52 (116)	45 (107)
Republican	13 (95)	7 (132)	26 (31)	25 (93)
Grade School*	47	38	84	71
High School	37	39	68	57
College	25	26	63	44
Low Income	38	46	77	63
High Income	27	30	61	51
Whites	28	32	62	54

*N's for remaining categories are same as in table 2.

differences attributable to partisanship. All Democrats vote heavily for Carter regardless of ideology; all Republican identifiers supported Ford at high rates despite ideological classification. However, the voting tendencies of ideological groupings do appear even when party is controlled. Among Democratic identifiers, the highest rates of defection are among libertarians and then conservatives, while liberals and populists supported Carter at the highest rates. Among Republicans, more defections from Ford occur in the liberal and populist groups; Ford held 93 percent of the conservatives and 87 percent of libertarians. Furthermore, the figures among independents are similar in direction to those of the total sample. Party identification obviously was a better single explanation of presidential vote choice in 1976, but our ideological classification offers an additional set of evidence about partisan defection rates and about the behavior of independents. The remainder of table 4 presents the vote for Carter by ideological classification, controlling for education, income, and race. Here we find that, although there is some variation in the magnitude of support for Carter across ideological groups when demographic factors are controlled, the same general directions are present in almost every case: The order of Carter's support goes from liberal, populist, conservative, to libertarian. Only in the case of grade-school-educated respondents do we find any variations, but the small cell size here may account for the findings.

Another means of testing the utility of our typology is to examine voter perception of the candidates' standing on the issues. The 1976 survey asked respondents to evaluate the presidential candidates' positions on the three economic-intervention questions and two of the individual-liberties questions. (No question was asked about candidate stand on abortion.) The data in table 5 indicate that, in general, the four ideological types evaluate candidates consistent with our expectations. Liberals and populists who voted for Carter generally perceived Carter as being more favorable to government economic intervention, while conservatives and libertarians who voted for Carter perceived him as being more opposed to these government actions. When we turn to two individual-liberties questions we find a different set of perceptions. Here liberals and libertarians who voted for Carter tend to perceive his position similarly while conservative and populist Carter supporters saw him as being more opposed to expanding individual liberties. Thus for Carter supporters the fourfold classification provides an explanation for voter perceptions of the candidate that the liberal-conservative continuum by itself could not.

For Ford voters the patterns are not quite as clear. On government health insurance and government jobs, liberal and populist Ford voters perceived Ford as more in favor of government intervention, while conservatives and libertarian Ford voters saw

Table 5

Perception of Candidate Issue Positions*
by Their Supporters, According to Ideological Type

	Carter Voters' Perception of Carter				Ford Voters' Perception of Ford			
Economic Issues								
	Lib.	Pop.	Cons.	Lbt.	Lib.	Pop.	Cons.	Lbt.
Progressive Taxation	2.91	3.28	3.73	4.13	4.05	3.84	4.33	4.40
Government Health Insurance	2.94	3.29	3.29	3.69	3.72	3.40	4.83	5.10
Government Jobs	3.13	2.97	3.61	3.50	4.50	3.69	5.04	4.93
Individual-Liberties Issues								
	Lbt.	Lib.	Cons.	Pop.	Lbt.	Lib.	Cons.	Pop.
Legislation Marijuana	4.40	3.90	4.97	5.37	4.21	4.57	4.98	5.35
Equal Role For Women	2.62	2.82	3.63	3.41	3.17	3.64	3.59	3.66

*Figures shown are the mean score for each group's perception of the candidate's positions on a 1-7 scale. The lower the score the more the candidate is perceived as supporting the policy in question

him as being opposed. On progressive taxation, the distinctions in perceptions of Ford were minor and not consistent with our expectations. On legalization of marijuana, most voters saw Ford as opposing such a move, although the libertarians and populists clearly saw Ford's position quite differently. On women's rights, the Ford libertarians perceived Ford as being slightly favorable, while the other three groups perceived Ford's position as barely on the favorable side. In summary, the perception of the candidates by their supporters generally is predictable by a supporter's belief system. By a simple liberal-conservative distinction, liberals and conservatives should represent two opposing views of the candidates' positions. In fact, we find that liberal and populist voters perceive their candidates similarly on economic issues, with conservatives and libertarians' perceptions of the candidate clustered together in the opposite direction. When we look at individual-liberties issues, we find that libertarians and liberals perceive the candidates similarly (especially for Carter voters), while conservatives and populists share a different set of perceptions.

Conclusion

We have presented an alternative approach to the analysis of mass belief systems, showing that it is useful to conceptualize mass belief systems in terms of two dimensions -- government intervention in economic affairs, and expansion of individual liberties -- rather than in terms of the traditional liberal-conservative continuum. Using these two dimensions, we defined four ideological categories, which we label liberal, conservative, populist, and libertarian. We believe our approach more accurately reflects the complexities of the philosophical traditions of liberalism and conservatism as well as the realities of contemporary politics. The interrelationships of economic freedom and personal freedom have been much debated in the development of western political thought in the last two centuries; our use of a two-dimensional approach to mass belief systems more accurately reflects this debate. In addition, the literature analyzing elite behavior -- Congress and courts, for example -- often is forced beyond the single liberal-conservative dimension. We see our approach as a logical extension of previous research, rather than a totally new departure.

By clarifying the liberal and conservative labels and adding two new categories, we are able to more completely explain the behavior of the American electorate than can be done with a unidimensional approach. We find tendencies for our four groups to behave differently (even after controlling for various demographic factors) in such areas as party identification, presidential vote, and evaluation of candidates' issue positions. Further, we can speculate that the existence of two major groups of people who hold political beliefs for which the traditional language and labels of American politics provide more confusion than clarity has long-range implications for the political system.

For example, growing evidence suggests that the traditional coalitions of the two parties are changing, that the number of independent identifiers is increasing, that split-ticket voting is growing, and that in general the electorate is more volatile and less predictable now than in the immediate past. Evidence of dissatisfaction with political parties (among other institutions) is also plentiful. While these changes relate in part to the impact of television, changing campaign styles, improved education, and the cumulative impact of the perceived failures and scandals of political institutions in recent years, they may also be related to the presence of two ideological groups in society whose belief systems are not reflected by the Democratic or the Republican party nor by their candidates.

If our analysis is correct, the major parties and their candidates will have to deal with the presence of at least four, rather than two, ideological groupings in the American electorate. And those who seek to predict or explain voter behavior including voter apathy will especially have to recognize these four distinct groups.

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(202) 546-0200

GOLD STANDARDS AREN'T ALL THE SAME, ECONOMIST SAYS

WASHINGTON, September 9, 1982 -- Most of the current proposals for a gold standard fail to address the fundamental cause of monetary instability, according to an economist writing for the Cato Institute.

Joseph T. Salerno, assistant professor of economics at Rutgers University, writes that the root cause of inflation is the "almost absolute monopoly over the supply of money" that government enjoys. This leads governments to engage in inflation, "a relatively simple, costless, and secure means for amassing money assets."

Accordingly, Salerno advocates the "denationalization" of money, which would yield "a money whose value is fully secured against arbitrary political manipulations of its supply."

"Advocacy of the gold standard," he writes, "is based on the view that governments are inherently inflationary institutions; therefore, the only realistic and lasting solution to the problem of inflation is to completely separate the government from money and return the latter institution to the free market whence it originally emerged."

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Unfortunately, many of the gold standard proposals being discussed today would not accomplish that. The gold "price rule" advocated by supply-siders like Arthur Laffer, Jude Wanniski, and Robert Mundell "is not a blueprint for the gold standard." Rather, it is basically similar to the monetarists' quantity rule and would not stop the inflation that is inherent in government monetary control.

Businessman-scholar Lewis Lehrman, now a candidate for governor of New York, is an advocate of the "classical" gold standard. "The most serious weakness of the classical gold standard, and of Lehrman's proposal," writes Salerno, "is the predominant role played by what Lehrman himself calls 'a monopoly central bank.'...To grant to a government institution, such as a central bank, a powerful influence over the operation of the gold standard is not unlike proffering the fox an invitation to guard the chicken coop." While the classical gold standard would be superior to our current fiat-money arrangement, "it will not rid us of the recurring fluctuations in macroeconomic activity which have plagued the market economy for the past two centuries."

Salerno concludes, "The road to long-term monetary stability leads ultimately to the complete abolition of the government monopoly of issuing money and, concomitantly, to the return of the function of supplying money to the free market. The most crucial and difficult step along this road -- though certainly neither the first nor the last -- involves reconstituting the dollar, the existing fiat money,

as a commodity money. This would be done by restoring it to its original status as a legally redeemable claim to a fixed weight of the former money-commodity, gold. Only if and when this step is taken is there hope of ever achieving the ultimate aim of a wholly 'denationalized' money whose supply and value are at long last free from the arbitrary manipulations of a nonmarket monopolist."

Salerno's study, entitled "The Gold Standard: An Analysis of Some Recent Proposals," is part of the Cato Institute's Policy Analysis series and is available from the Cato Institute, a Washington-based public policy research institute. The Institute has published widely in the area of inflation and monetary policy, and will release a book on the subject later this month.

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CATO INSTITUTE POLICY ANALYSIS

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THE GOLD STANDARD: AN ANALYSIS OF SOME RECENT PROPOSALS

By Joseph T. Salerno

The case for a free-market commodity money as provided by a genuine gold standard is simple yet decisive. It is based on the insight that the root cause of inflation in the modern world is the almost absolute monopoly over the supply of money which all national governments possess within their respective political jurisdictions. That such an arrangement necessarily produces inflation is not difficult to explain.

To begin with, almost all governments obtain the bulk of their revenues through taxation which, regardless of its particular form, ultimately involves -- indeed, is definable as -- a coerced levy upon the monetary incomes or assets of its citizens, i.e., the net taxpayers. However, whatever ethical or practical considerations may be brought forward to justify taxation, since it is essentially coercive, tax increases have always found little favor among the citizenry. So, ever fearful of arousing popular unrest, governments naturally sought alternative means for augmenting their revenues from taxation. It was for this purpose that all national governments eventually secured for themselves a legal monopoly of issuing money, empowering them to inflate, i.e., to create new money, virtually at will.

Especially under today's various national fiat-money standards, inflation provides a relatively simple, costless, and secure means for amassing money assets. In substance, all a government needs to do to increase its real income is slap some ink on paper and spend the proceeds on commodities and services produced by the private market. In this way, the national government is able to divert scarce resources from private uses and utilize them for its own purposes, while circumventing the popular discontent which invariably accompanies an overt imposition of higher taxes. Actually, in the world of modern monetary and financial institutions and practices, inflation entails a much more arcane process than the mere printing and spending of new units of currency.

Joseph T. Salerno is an assistant professor of economics at Rutgers University.

This fact obscures the true cause of inflation from the public and permits the government to shift the blame for the monetary unit's shrinking purchasing power and other undesirable consequences of inflation from itself to other groups or to circumstances beyond its control. These include OPEC, monopolistic corporations, powerful labor unions, spendthrift consumers, unfavorable weather conditions, etc.

It should be no surprise, then, that all government-monopolized fiat moneys exhibit symptoms of inflationary disorder -- just as it is no surprise when other groups in the economy exploit the monopoly privileges granted them by law to increase their money incomes, e.g., via tariffs, occupational licensure, exclusive public franchises, etc. Indeed, it is a general lesson of history as well as a rule of common sense that an individual or group endowed with a legal monopoly over <u>any</u> area of the economy will use it to its own pecuniary advantage. To put it rather bluntly, government is an inherently inflationary institution and will ever remain so until it is dispossessed of its monopoly of the supply of money.

Indeed, lately an increasing number of economists have come to regard inflation as a necessary consequence of the political control of money. Most prominent among them is F. A. Hayek, Nobel laureate in economics, who has forcefully argued that the recurring bouts of macroeconomic instability which have always afflicted market economies are "a consequence of the age-old government monopoly of the issue of money."[1] According to Hayek, furthermore:

> ... there is no justification in history for the existing position of a government monopoly of issuing money. It has never been proposed on the ground that government will give us better money than anybody else could. It has always, since the privilege of issuing money was first explicitly represented as a Royal prerogative, been advocated because the power to issue money was essential for the finance of government -- not in order to give us good money, but in order to give to government access to the tap where it can draw money it needs by manufacturing it. That, ladies and gentlemen, is not a method by which we can hope ever to get good money. To put it into the hands of an institution which is protected against competition, which can force us to accept the money, which is subject to incessant political pressure, such an authority will not ever again give us good money.[2]

Even "mainstream" economists have begun to express similar views. For example, respected monetary theorist Robert J. Barro concludes in a recent study:

> In relation to a fiat currency regime, the key element of a commodity standard is its potential for automaticity and consequent absence of political control over the quantity of money and the absolute price level... The choice among different monetary constitutions -- such as the gold standard, a commodity-reserve standard, or a fiat standard with fixed rules for setting the quantity of money...may be less important than the decision to adopt <u>some</u> monetary constitution. On the other hand, the gold standard actually prevailed for a substantial period (even if from an "historical accident," rather than a constitutional choice process), whereas the world has yet to see a fiat currency system that has obvious "stability" properties.[3]

And William Fellner of the American Enterprise Institute reluctantly admitted recently that there is a "substantial element of truth involved in the assertion that fiat money has been misused in all history -- has always led to the corruption of the currency."[4]

At this point, it should be noted that the fatal flaw in the monetarist program for monetary stability lies in the fact that its policy prescriptions completely fail to address the fundamental cause of inflation, namely, the governmental monopoly over money. The monetarist "quantity rule," according to which a governmental agency such as the Fed is to maintain a stable rate of growth in the quantity of money, is not an anti-inflation <u>policy</u> at all. It is merely the enunciation of a request that the political authorities exercise restraint in exploiting their monopoly of issuing money, which, under the monetarist program, would remain virtually intact. Such a request, I might add, is incredibly naive in the light of theory and history.

The virtue of a genuine, 100-percent gold standard, in contrast, is precisely that it establishes a free market in the supply of money and, in doing so, brings about a complete abolition of the governmental monopoly in this most sensitive and vital area of the market economy. Under a pure commodity money, the money-supply process is totally privatized: The mining, minting, certification, and storage of the money commodity as well as the issuance of fully covered, i.e., 100-percent gold-backed, bank notes and deposits are carried out by private firms operating in a free market.

The complete "denationalization" of money which thus occurs under a genuine gold standard yields a money whose value is fully secured against arbitrary political manipulations of its supply. Under the gold standard, the quantity of money and hence its value is determined solely by market forces, such as the demands of the public for money and the costs associated with digging up gold. While the purchasing power of a pure commodity money such as gold, like the price of any commodity on the free market, therefore tends to fluctuate according to changes in its supply and demand, there exists an inherent long-run tendency to stability in the value of such a money.[5] This contrasts sharply with a government-monopolized fiat money which, as noted above, is inherently inflationary and subject to large, unpredictable fluctuations in value over both the short- and long-terms.

It is noteworthy that, although he regards a pure commodity standard as ultimately undesirable because of its high resource cost, Milton Friedman recognizes its unique potential as a guarantee of monetary stability. Writes Friedman:

> If money consisted wholly of a physical commodity...in principle there would be no need for control by the government at all...
>
> If an automatic commodity standard were feasible, it would provide an excellent solution to the liberal dilemma of how to get a stable monetary framework without the danger of irresponsible exercise of monetary powers. A full commodity standard, for example, an honest-to-goodness gold standard in which 100 percent of the money consisted literally of gold, widely supported by a public imbued with the mythology of a gold standard and the belief that it is immoral and improper for government to interfere with its operation, would provide an effective control against government tinkering with the currency and against irresponsible monetary action. Under such a standard, any monetary powers of government would be very minor in scope.[6]

To briefly sum up, advocacy of the gold standard is based on the view that governments are inherently inflationary institutions; therefore, the only realistic and lasting solution to the problem of inflation is to completely separate the government from money and return the latter institution to the free market whence it originally emerged.

Proposals for a Gold Standard

We now turn to a critical examination of a number of recent proposals which aim at once again giving gold a role in the U.S. monetary system. Although these plans vary significantly in basic conception as well as institutional details, all but one suffer, to a greater or lesser degree, from the same fundamental flaw: they leave intact the current government monopoly of money. For purposes of discussion, these monetary reform proposals may be grouped under four headings: the gold-certificate reserve, the gold "price rule," the classical gold standard, and the parallel private gold standard.

The Gold-Certificate Reserve

Robert E. Weintraub, senior economist for the Joint Economic Committee, has proposed the reinstatement of the gold-certificate reserve requirement for Federal Reserve notes.[7] Under Weintraub's plan, the Fed would be legally required, as it was prior to 1968, to maintain a reserve of gold certificates whose value, at a stipulated legal price of gold, would be a fixed proportion of its outstanding note liabilities. Before 1968, when the legal or "par" value of gold was $35 per ounce, the reserve requirement was 25 percent, and so, in effect, each dollar of currency in circulation was "backed" by 25 cents in gold. Weintraub's plan "would require that the Federal Reserve banks hold at least 9 cents in gold certificates at their legal value [$42.22 per ounce since 1973] behind each dollar of note liabilities in perpetuity."[8] The nine percent reserve requirement reflects the ratio of par value gold certificates held by the Fed to its note liabilities prevailing at the end of 1980.

According to Weintraub:

> Legislation to keep the percent of legal value gold certificates behind Federal Reserve notes what it was at the end of 1980 in perpetuity would prevent any future currency growth. And, unless the public wanted to hold an increasing part of its total transactions balances (currency plus checking deposits in depository institutions) in the form of checking deposits, preventing currency growth would prevent any future growth in the transactions or exchange media measure of money.[9]

However, Weintraub finds such a result undesirable because he believes that some growth in the money supply is necessary "to accommodate our economy's long-term growth

potential."[10] His proposal, therefore, includes a provision for increasing the legal value of gold, which would initially be set at the current $42.22 per ounce, at a stipulated monthly rate. This would bring about an effective expansion in the Fed's reserve of gold certificates and permit a corresponding increase in the currency in circulation and, hence, in the overall money supply. Weintraub favors an annual rate of increase in the par value of gold which would ultimately facilitate a three percent per annum rate of growth in the supply of money.

Weintraub expresses the belief, moreover, that "the plan should prove attractive to both monetarists and gold standard advocates."[11] In fact, it should appeal to neither group and for good reason.

To begin with, Weintraub's plan is essentially an attempt to realize through legislation the monetarist goal of a steady and predictable rate of growth of the money supply within the existing fiat-money framework. Its main drawback, from the monetarist perspective, is that it involves a needlessly complicated and cumbersome technique to achieve the desired goal. Why not simply legally mandate the Fed to pursue a straightforward "quantity rule," as the monetarists have always argued? Weintraub does not provide an answer to this question.

Advocates of a gold standard, on the other hand, also should find little to be pleased about in this proposal because a gold-certificate reserve requirement is not a genuine gold standard at all. Under the gold standard, the monetary unit _is_ a weight unit of gold; under Weintraub's plan, gold is not money but a reserve commodity which is supposed to restrain the creation of government fiat money. Furthermore, since Weintraub's proposal leaves untouched the government monopoly of the money supply, it is unreasonable to expect that the gold-certificate reserve requirement, even if enacted, would long serve as a bulwark against inflation. The most likely prospect is that it would be gradually reduced and finally eliminated altogether, no doubt in the wake of a series of "emergencies." Indeed, Weintraub fully recognizes and is prepared for such a prospect, arguing that his plan "could be amended if the constraint proved to be harmful, and probably it could be changed or repealed in a day or two in such unlikely case."[12] Needless to say, this hardly recommends it as a durable barrier against inflation.

Moreover, past experience with the gold-certificate reserve also leads to the expectation that it would provide a weak and easily manipulated restraint on inflation. Thus, up until World War II, the Fed was legally required to hold

a 35 percent gold-certificate reserve for its deposit liabilities and a 40 percent reserve for its note liabilities. To facilitate the wartime inflation, the reserve requirement was reduced to 25 percent for both the Fed's note and deposit liabilities. As a result of persistent, inflation-induced balance-of-payments deficits, the gold-certificate reserve requirement for the Fed's deposit liabilities was abolished in 1965, while the reserve requirement for its note liabilities was finally eliminated in 1968.

In conclusion, what Weintraub proposes is not a gold standard but an unwieldy and historically ineffective expedient designed to mitigate the inflationary tendencies of a government fiat money.

The Gold "Price Rule"

The gold "price rule" denotes the monetary reform proposal put forth in various forms by a number of supply-siders including Arthur Laffer,[13] Robert Mundell,[14] and Jude Wanniski.[15] Laffer's detailed formulation of the proposal has also served as the basis of the Gold Reserve Act of 1980, a bill introduced in Congress by Sen. Jesse Helms.[16]

According to Laffer's blueprint, at the end of a previously announced transition period of three months, the Federal Reserve would establish an official dollar price of gold "at that day's average transaction price in the London gold market."[17] From that date onward, the Fed would stand ready to freely convert dollars into gold and gold into dollars at the official price. In addition, "when valued at the official price, the Federal Reserve will attempt over time to establish an average dollar value of gold reserves equal to 40 percent of the dollar value of its liabilities."[18] This level of gold reserves Laffer designates the "Target Reserve Quantity."

Once Laffer's plan was fully operational, the Fed would have full discretion in conducting monetary policy through discounting, open market operations, etc., provided that: the dollar remains fully convertible into gold at the official price; and the quantity of actual gold reserves does not deviate from the Target Reserve Quantity by more than 25 percent in either direction, i.e., actual gold reserves do not fall below 30 percent or rise above 50 percent of the Fed's liabilities, which are also known as the "monetary base." However, should gold reserves decline to a level between 20 percent and 30 percent of its liabilities, the Fed would lose all discretion in determining the monetary base which, as a result, would be completely frozen at the existing level. If, in spite of this, gold reserves contin-

ued to decline to between 10 percent and 20 percent of the Fed's liabilities, the Fed would be legally constrained to reduce the monetary base at the rate of one percent per month.

Should these measures prove incapable of arresting the decline in the dollar value of gold reserves before it reaches less than 10 percent of Fed liabilities, then:

> The dollar's convertibility will be temporarily suspended and the dollar price of gold will be set free for a three month adjustment period.
>
> During this temporary period of inconvertibility, the monetary authorities will be required to suspend all actions that would affect the monetary base. Again, the price of gold would be reset as before and convertibility would be reinstated.[19]

Laffer's plan also includes "a symmetric set of policy dicta" which are to be implemented in the case in which actual gold reserves exceed the Target Reserve Quantity.

It must first be pointed out that Laffer's monetary reform proposal, whatever its merits or drawbacks, is <u>not</u> a blueprint for the gold standard. Rather, it is an outline of an elaborate scheme for legally constraining the monetary authority to adhere to a "price rule" in determining the supply of fiat money in the economy. In fact, as Laffer himself has made clear recently, gold has no necessary role in the implementation of such a price rule. According to Laffer and Miles:

> ... the Fed would institute its dollar "price rule" by stabilizing the value of the dollar in terms of an external standard. This standard would be a single commodity or a basket of commodities (a price index)...
>
> Regardless of precisely which external standard is chosen, there are two basic rules of Fed behavior under the price rule. First, if the dollar price of the standard starts to rise (the dollar starts to fall in value), the Fed must reduce the quantity of dollars through open market sales of bonds, foreign exchange, gold, or other commodities. Second, if the dollar price starts to fall (the dollar rises in value), the Fed must increase the quantity of dollars through open market purchases of bonds, foreign exchange, gold or other commod-

ities. The Fed is charged with keeping the value or price of the dollar stable in terms of the external standard.[20]

Even if gold is chosen as the "external standard" in the price-rule regime, it is not itself money, as in the case of a genuine gold standard, but merely "the intervention asset" or "the item for which dollars are exchanged."[21]

Thus stripped of its gold-standard terminology, Laffer's price rule appears as a technique designed to control inflation under the current fiat-money standard. It is thus very similar in nature, if not in technical detail, to the quantity rule advocated by the monetarists. This is clearly evident in Laffer and Miles' admission that "in an unchanging world where all information is freely available, there of course would be a 'quantity rule' which would correspond to a given 'price rule.'"[22] In fact, Miles and Laffer prefer a price rule to a quantity rule because they believe that, under the current monetary system, the former is technically superior to the latter in "restraining the supply of dollars."[23]

Thus, under close examination, Laffer's plan turns out to be, in essence, a kind of price-rule monetarism, the references to gold notwithstanding. As such, it is vulnerable to criticism on precisely the same grounds as the more conventional quantity-rule monetarism. The most serious criticism of both varieties of monetarism is that they fail to come to grips with the root cause of inflation, namely, the government monopoly of the supply of money. This is true of Laffer's plan despite the elaborate set of legal sanctions which would be invoked against the monetary authorities for their violations of the price rule. For, in the end, such sanctions, even if rigorously applied, do not prevent inflation but merely respond to a fait accompli. This point is implicitly recognized by Laffer who includes in his plan a provision for "temporary periods" of dollar inconvertibility. These would readjust the official gold price following sustained bouts of monetary inflation which cause gold reserves to fall below the legally permissible lower limit.

Furthermore, as in the case of the gold-certificate reserve, we may appeal to history for evidence regarding the success of the gold price rule in stanching the flow of government fiat currency. We need look no further than the late, unlamented Bretton Woods System (1946-1971). Under this "fixed-exchange-rate" system, the U.S. monetary authority followed a gold price rule, buying and selling gold at an officially fixed price of $35 per ounce. Foreign monetary authorities, on the other hand, pursued a dollar price rule, maintaining their respective national currencies convertible

into dollars at a fixed price. According to Laffer and Miles, "as long as the rules of the system were being followed, the supplies of all currencies were constricted to a strict price relationship among one another and to gold."[24]

Unfortunately, "the rules of the system" were subjected to numerous and repeated government violations and evasions, including frequent outright "readjustment" of the price rules, i.e., exchange-rate devaluations, when they became inconvenient restraints on the inflationary policies pursued by particular governments.[25] Needless to say, the Bretton Woods System did not prevent the development of a worldwide inflation which brought the system to its knees in 1968 and led to its final collapse in 1971.

After duly noting the political manipulations involved in the destruction of the Bretton Woods System,[26] Laffer and Miles clearly delineate the reasons why governments prefer and benefit from the removal of any and all checks on their power to inflate the money supply:

> Why should governments be biased toward increasing the money supply at a faster rate? There are essentially two incentives -- a political incentive and a financial one. The political incentive is political survival. Many politicians, especially those up for reelection, are familiar with the theory that increases in the money supply promote expenditure, increase GNP, and reduce unemployment. These changes in turn are assumed to make the citizens of the country look more kindly upon the incumbent government. While there may be some validity in this theory, unfortunately it is often implemented under the notion that if a little money creation is good, a lot must be even better.
>
> The financial motive for printing money is the fact that while money is practically costless to produce, it can be used for purchasing goods and services. The resulting seignorage represents revenue to the government. Revenue gathered in this way means less revenue must be gathered in another way, say, through direct taxation.
>
> Given these incentives to print money, it can be seen why removal of the monetary contraints on governments tends to create inflation rather than deflation.[27]

Given his recognition of the powerful inflationary bias built into the political process and of the historical fail-

ure of monetary price rules to hold such a bias in check, Laffer's advocacy of a renewed gold price rule is something of a mystery.

The Classical Gold Standard

Over the past few years, the case for reinstituting the "classical" gold standard has been propounded with great vigor and insight by Lewis Lehrman, a businessman and scholar whose views were influential in formulating the economic policy agenda of the Reagan administration and who is now a candidate for governor of New York.[28] Lehrman's writings are heavily influenced by the ideas of his former teacher, the late French economist and longtime gold-standard advocate, Jacques Rueff.[29]

Like his mentor, Lehrman advocates a genuine gold standard which "would establish the dollar as a weight unit of gold."[30] As Lehrman explains:

> Under the gold standard there is no price for gold. The dollar is the monetary standard, set by law equal to a weight of gold. The price of gold does not exist....Under the gold standard, the paper dollar is a promissory note. It is a claim to a real article of wealth defined by law as the standard.[31]

In Lehrman's proposal, Federal Reserve notes as well as dollar-denominated demand deposits at commercial banks and other depository institutions would once more become (as they were prior to 1933) warehouse receipts for gold, instantly redeemable for gold dollars at face value upon the demand of the bearer or depositor. Legal reserve requirements for bank deposits would be superfluous since "the failure to redeem...excess dollars for gold would, under convertibility rules, threaten the bankruptcy and dissolution of a commercial bank."[32] The monetary authority, for its part, would be "constrained...by law to redeem excess dollars with specified weight units of gold..."[33] Or, in other words, it must stand ready "...to buy and sell at the official rate all the gold offered or all the gold demanded."[34] The Fed would furthermore be restrained from carrying out any open-market operations, although it would be permitted to lend reserves to commercial banks at an "unsubsidized" discount rate, i.e., a rate at or slightly above the market rate.

Without going into further detail, it is clear that Lehrman proposes a monetary system which very closely approximates the classical gold standard with all its strengths and weaknesses. The most serious weakness of the classical

gold standard, and of Lehrman's proposal, is the predominant role played by, what Lehrman himself calls, "a monopoly central bank."[35] Yet, Lehrman is willing to countenance the existence of such an institution and, indeed, to cede significant powers to it so long as it adopts "reasonable self-denying ordinances."[36] Thus, for example, the Fed would be expected to abstain from manipulating the gold content of the dollar or from directly purchasing assets on the open market. On the other hand, under Lehrman's plan, it would still retain its monopoly of the note issue and its position as the central warehouse and clearinghouse for commercial bank reserves. Moreover, its discretion with regard to discount-rate policy would still permit it to function as a "lender of last resort."

With so much power over the monetary system thus concentrated in the hands of a government institution, it is no wonder that Lehrman refers to the gold standard repeatedly as a "political institution"[37] and not once as a "free-market institution." In fact, at one point Lehrman comes perilously close to conceiving the gold standard as price-rule monetarism, that is, as merely an efficient political technique for controlling the government monopoly of the money supply. Thus, he writes:

> To be sure, Monetarists would claim to fix the total quantity of money, through a specified money stock rule, in order to regulate the government monopoly (the Federal Reserve Board) which supplies cash balances to the market. Yet the simpler, market-related technique would be to make the value of a unit of money equal to a weight unit of gold, in order to regulate the same monopoly.[38]

In any case, since government is an inherently inflationary institution, it can be expected to be an implacable enemy of the gold standard. Under these circumstances, to grant to a government institution, such as a central bank, a powerful influence over the operation of the gold standard is not unlike proffering the fox an invitation to guard the chicken coop. This is surely the lesson taught by the broad sweep of monetary history, especially in more recent times as we witness Western governments employing every means at their disposal to progressively transmogrify the classical gold standard into our current, highly inflationary system of fluctuating national fiat currencies. Von Mises does not exaggerate when he states:

> ...the gold standard did not collapse. Governments abolished it in order to pave the

> way for inflation. The whole grim apparatus of oppression and coercion -- policemen, customs guards, penal courts, prisons, in some countries even executioners -- had to be put into action in order to destroy the gold standard. Solemn pledges were broken, retroactive laws were promulgated, provisions of constitutions and bills of rights were openly defied.[39]

Von Mises proceeds to demolish the deeply entrenched myth, that Lehrman appears to accept, which likens the gold standard to a political "game" wherein the government players must adhere to some vaguely specified "rules of the game." Writes von Mises:

> But the gold standard is not a game; it is a market phenomenon, and as such a social institution. Its preservation does not depend on the observation of some specific rules. It requires nothing else than that the government abstain from deliberately sabotaging it. To refer to this condition as a rule of an alleged game is no more reasonable than to declare that the preservation of Paul's life depends on compliance with the rules of Paul's-life game because Paul must die if somebody stabs him to death.[40]

In summary, there is no compelling reason to believe -- and one searches Lehrman's writings in vain to find any argument to the contrary -- that the classical gold standard will prove to be a more durable barrier to political manipulation of the money supply the second time around than it was the first time.

Aside from its overriding political flaw, Lehrman's proposal is characterized by serious economic shortcomings. These are ultimately related to the fact that the type of gold standard that Lehrman proposes is what Hayek has termed a "national reserve system."[41] The essential feature of such a system is fractional-reserve banking, combined with the concentration of the ultimate cash reserves of all the nation's banks in the nation's financial center or, more likely, in the government central bank.

An historical example of the operation of the national reserve system is provided by the classical gold standard. Under this system, the central bank generally holds the ultimate cash reserve -- in this case, gold -- for the entire national banking system. The gold reserve serves as immediate backing for the central bank's note and deposit liabili-

ties which, in turn, constitute the reserve base for the notes and deposits of commercial banks. The latter are held, along with central bank notes and gold itself, in the money balances of the public. Since both the central bank and the commercial banks hold fractional reserves against their liabilities, the money and credit structure of the economy resembles an inverted pyramid, with a relatively narrow base of gold reserves supporting a much larger superstructure of bank notes and deposits ultimately convertible into gold.

As a result, the classical gold standard was and is extremely vulnerable to monetary deflations and inflations, due to balance-of-payments disequilibria, changes in the public's preferences for holding gold vis-a-vis bank notes and deposits, financial crises, etc. The reason for this is that any loss or gain of gold reserves by the banking system causes a multiple expansion or contraction of bank notes and deposits, which constitute a large proportion of the money supply. These frequent bouts of monetary inflation and deflation, moreover, are likely to be aggravated by the fact that the very mechanism by which the banking system adjusts to changes in the gold reserve base involves an artificial alteration in the entire structure of interest rates in the economy. This leads to a distortion in productive activity.

A brief example will suffice to illustrate this point. Suppose that the central bank is faced with an influx of gold reverses due to a balance-of-payments surplus. In order to arrest and reverse this inflow, it will lower the discount rate and thus expand its loans to commercial banks. Commercial bank reserves will, as a result, increase, and, while maintaining their accustomed or legally required ratio between reserves and liabilities, the banks will be able to profitably increase their loans by lowering the interest rate they charge. Since the bulk of these loans are taken up for investment purposes, investment spending in the economy will rise relative to consumption spending. This will naturally induce a shift of productive resources and monetary investment out of consumer goods industries and into capital goods industries.

Unfortunately, this outcome, the fall of interest rates and the decline of consumption relative to investment, does not reflect a genuine and voluntary shift in the time preferences of the public, i.e., deliberate choices to save more of their income and spend less on consumption. Consequently, the expansion of capital goods industries at the expense of consumer goods industries will eventually prove to be unsustainable, resulting in widespread unemployment and business failures when economic activity is finally readjusted to more faithfully reflect the time preferences of consumer-

savers in the economy. As a matter of fact, the day of reckoning will come when the monetary inflation engineered by the central bank has raised prices and incomes in the country sufficiently so that the balance-of-payments surplus is transformed into a deficit and gold begins to flow out of the country. In order to staunch the outflow of gold reserves, the central bank is constrained to raise its discount rate which, in turn, drains reserves out of the banking system and causes a rise in bank loan rates and a corresponding contraction in bank loans and, ultimately, in the money supply. As the structure of interest rates in the economy begins to readjust to reflect the voluntary social allocation of income between consumption and saving, the numerous malinvestments and resource misallocation engendered by the previous inflationary boom are revealed and corrected amidst conditions of economic depression.

In light of the foregoing analysis, it is my belief that Lehrman's plan for restoring the classical gold standard, while it will undeniably provide greater long-run stability in the value of money than the present fiat-money regime, will not rid us of the recurring fluctuations in macroeconomic activity which have plagued the market economy for the past two centuries. I hasten to stress that this is not a defect of the gold standard itself but of its organization along the lines of the national reserve system described above. In fact, most of the oft-noted defects in the classical gold standard lie in precisely those areas where its operation diverges from that of a fully free-market, 100 percent gold standard. This point has been cogently argued by Leland Yeager:

> National fractional reserve systems are the real source of most of the difficulties blamed on the gold standard....The difficulties arise because the mixed national currencies -- currencies which are largely paper only partly gold -- are insufficiently international. The main defect of the historical gold standard is a necessity of "protecting" national gold reserves.... In short, whether a Central Bank amplifies the effects of gold flows, remains passive in the face of gold flows, or "offsets" gold flows, its behavior is incompatible with the principles of the full-fledged gold standard....Indeed, any kind of monetary management runs counter to the principles of the pure gold standard.[42]

On the other hand, notes Yeager:

> Under a 100 percent hard-money international

> gold standard, the currency of each country would consist exclusively of gold (or of gold plus fully-backed warehouse receipts for gold in the form of paper money and token coins). The government and its agencies would not have to worry about any drain on their reserves. The gold warehouses would never be embarrassed by requests to redeem paper money in gold, since each dollar of paper money in circulation would represent a dollar of gold actually in a warehouse. There would be no such thing as independent national monetary policies; the volume of money in each country would be determined by market forces. The world's gold supply would be distributed among the various countries according to the demands for cash balances of the individuals in the various countries. There would be no danger of gold deserting some countries and piling up excessively in others, for each individual would take care not to let his cash balance shrink or expand to a size which he considered inappropriate in view of his income and wealth.
>
> Under a 100 percent gold standard...the various countries would have a common monetary system, just as the various states of the United States now have a common monetary system. There would be no more reason to worry about disequilibrium in the balance of payments in New York City. If each individual (and institution) took care to avoid persistent disequilibrium in his personal balance of payments, that would be enough....The actions of individuals in maintaining their cash balances at appropriate levels would "automatically" take care of the adequacy of each country's money supply.[43]

<u>The Parallel Private Gold Standard</u>

The most innovative scheme for establishing a gold money involves a wholly private, "parallel" gold standard which would exist side by side with the already established government fiat-money standard. Variations on this plan have been proposed by Henry Hazlitt[44] and Professor R. H. Timberlake.[45] Although I shall focus primarily on Timberlake's proposal because it is worked out in greater detail, reference will be made to Hazlitt's proposal to highlight several substantive differences between the two.

Timberlake's plan holds forth great initial promise because, unlike the preceding three plans that have been examined, it is predicated on the recognition that inflation "will be stopped only by fundamental changes in the Fed."[46]

Thus, Timberlake's plan "would begin with the abolition of the Federal Reserve System as a policy-making central bank."[47]

Timberlake foresees no technically insurmountable barriers to such a course of action. He argues that the regulatory functions of the Fed can easily be dispensed with since "banks have no more reason to be regulated than grocery stores" and "should be left alone to justify their existence in a free-market system."[48] Regarding the check-clearing services provided by the Fed to its member banks, Timberlake points to privatization as the simple and sensible solution. Writes Timberlake:

> The technical check-clearing operations of the Federal Reserve Bank could still be handled by the existing physical facilities. Federal Reserve Banks could be reorganized as regional bank clearing houses. Since the Fed banks are already legally owned by commerical banks that exercise no control or ownership, the solution is simple: Turn the Federal Reserve Banks over to the legitimate owners and let the member banks operate them. This change would probably result in many interesting innovations and economies in bank management and checking facilities.[49]

This leaves the Fed's functions relating to the execution of monetary policy. According to Timberlake, they are at best superfluous and at worst highly inflationary. In the case of reserve requirements, Timberlake contends that "banks can manage their own reserve necessities," noting that "no other system in the world employs reserve requirement laws to regulate commercial banks."[50] The discounting function, Timberlake holds to be "both unnecessary and undesirable." Not only does it play a minor role in the Fed's execution of monetary policy, but commercial banks are able to fulfill their needs for reserves by borrowing from one another on the well organized and private Federal Funds market. "Ending Federal Reserve discounting," writes Timberlake, "therefore, would simply be ending something that is largely an advertising gimmick for promoting the image of the Fed as a banker's welfare agency."[51]

But what of open market operations, "the process that keeps the money stock growing at inflationary rates"? It is in answering this question that Timberlake introduces his proposal for a parallel gold standard. First, the U.S. Treasury would sell its entire gold stock (260 million ounces) or distribute a pro rata share to every U.S. citizen either in coin or in redeemable certificates. Second, the "policy-making structure of the Federal Reserve System" would be

abolished. Finally, the outstanding note liabilities of the Fed, the currency in circulation, would be frozen and the member-bank reserve accounts converted into Federal Reserve notes. The commerical banks would have the option of holding the latter in their own vaults or leaving them on deposit in the "new" regional clearinghouses.

Timberlake expects that the gold, once in private hands, would soon find its way into private depository institutions, thus giving rise to gold-based demand deposits and notes redeemable upon demand in gold or Federal Reserve notes, at the option of the depositor. According to Timberlake:

> This new system would not be a gold <u>standard</u> because the government would not declare gold or anything else legal tender....
>
> Gold-based deposits and currency would circulate side by side with the frozen stock of existing federal reserve notes. Prices of gold in terms of other moneys would be quickly determined by market factors.[52]

Timberlake's proposal includes two elements that are absolutely essential to the establishment of a stable commodity money: the complete liquidation of the government central bank; and the return of the gold stock to private hands. In this respect, it is far superior to the first three proposals which I have analyzed because all of them leave the existing structure of the Federal Reserve system, for the most part, untouched. Moreover, under the plans of Laffer and Lehrman, even though the public can convert dollars into gold, the Fed still retains strategic control over the nation's gold stock by virtue of its position as a monopoly "banker's bank."

Unfortunately, Timberlake's proposal involves two drawbacks. First, by stipulating only that depository institutions are legally required to redeem their notes and demand deposits for gold upon demand, Timberlake is opening the door to a system of "free banking" based on fractional reserves. Although this system would, in fact, produce a much sounder and "harder" money than even the classical gold standard, there would still be potential, albeit severely limited, for inflation. More important than the direct economic effects of such inflation, however, there looms the distinct possibility that the political authority may use the occasional, but highly visible, financial crises and bank failures which follow the inflationary boom as a pretext for regulation of the banks "in the public interest." Having thus regained its first crucial foothold, the government

would be well on its way to reimposing its monopoly over money.

There is a much more serious shortcoming in this plan, however. It is obscured by Timberlake's overly optimistic assumption that once the gold stock has been retrieved from government control, gold will be automatically and as a matter of course remonetized by the market, thus serving as the basis for a parallel private currency. But the sad fact is that the public, who ultimately determines what is and what is not money, has grown accustomed to governmental fiat money and, as a result, is unlikely to undertake spontaneously the pattern of actions necessary to create de novo a parallel commodity money. This is so despite the fact that the existing fiat money, e.g., the dollar, was at one time merely a name for a specific weight of gold, and despite the more general fact that money always initially emerges as a useful commodity produced on the free market. For once the government succeeds in severing the name of the monetary unit, which the public has grown accustomed to over the years, from the free-market money-commodity, a government-monopolized fiat money becomes entrenched among the public and the money-commodity is effectively demonetized. This is certainly borne out, for example, by the history of the dollar. Originally the name for approximately one-twentieth of an ounce of gold money (from 1834 to 1933), the dollar is today a purely nominal entity and, consequently, whatever is legally designated as a "dollar" is accepted by the public as money. Gold is now one among many nonmonetary commodities for which the fiat dollars are exchanged.

It follows from what has been said that, once a fiat money has gained currency in the economy, the only sure method for restoring a free-market commodity money necessarily involves once again legally defining the monetary name _already in use_ as some definite unit of weight of the former money-commodity. Of course, considerations of the prevailing economic reality -- namely, the enormous inflation of the supply of fiat dollars that has occurred since the severing of the gold-dollar link -- would determine the exact ratio at which the redemption of dollars for gold could be initiated and maintained without precipitating severe economic dislocations. But this is a complex issue which cannot be addressed here.

In light of the foregoing discussion, the most that could reasonably be expected from Timberlake's proposal is not the spontaneous emergence of a parallel gold standard at all, but the existing unitary fiat-dollar standard in which the monetary base, as embodied in the frozen stock of Federal Reserve notes, remains constant. Two important points can

be made regarding the inflationary potential of the reformed fiat-money regime which is actually likely to emerge under Timberlake's proposal.

First, even if we assume that the monetary base (equal to the total quantity of Federal Reserve notes held in the money balances of the public and in private bank reserves) remains rigidly fixed, there is still room for monetary inflation and deflation so long as fractional reserve banking exists (as it apparently would under Timberlake's proposal). Thus, for example, increased public preference for holding money balances in the form of demand deposits or private bank notes, as opposed to Federal Reserve notes, would result in an influx of Fed notes into private bank reserves, leading to the familiar process of a multiple expansion of bank credit for the system as a whole. The final result of this process would be an inflationary expansion of private bank notes and demand deposits. On the other hand, a contraction of the money supply would occur due to the public shifting some of its money holdings from, e.g., checking accounts to Fed notes in hand.

Second, and more important in the long run, although Timberlake's program laudably envisions the dismantling of the Federal Reserve system and the complete privatization of banking, the dollar, which constitutes the "high-powered" money or the ultimate reserves of the banking system, still remains an essentially nominal entity subject to inflationary creation by government fiat. Given its inflationary proclivity, it is highly improbable that the government will forever resist the opportunity to increase its revenues by expanding the supply of dollars.

In sum, Timberlake's proposal does not live up to its initial promise, either as a viable blueprint for achieving a free-market gold money or as a long-run cure for inflation. The reason underlying both shortcomings is that the proposal does not even address the most crucial issue of meaningful monetary reform: the denationalization of the *existing* fiat money.

Henry Hazlitt's proposal for a private parallel gold standard is much more modest in conception than Timberlake's, although he too wishes "to get government, as far as possible, out of the monetary sphere."[53] The first and most crucial step in Hazlitt's plan "is to get our government and the courts not only to permit, but to enforce, voluntary private contracts providing for payment in gold or in terms of gold value."[54]

The full plan would be implemented as follows:

> Governments should be deprived of their monopoly of the currency-issuing power. The private citizens of every country should be allowed, by mutual agreement, to do business with each other in the currency of any country. In addition, they should be allowed to mint privately gold or silver coins and to do business with each other in such coins... Still further, private institutions should be allowed to issue notes payable in such metals. But these should be only gold or silver certificates, redeemable on demand in the respective quantities of the metals specified. The issuers should be required to hold at all times the full amount in metal of the notes they have issued, as a warehouse owner is required to hold at all times everything against which he has issued an outstanding warehouse receipt, on penalty of being prosecuted for fraud. And the courts should enforce all contracts made in good faith in such private currencies.[55]

Hazlitt's proposal is at once less ambitious in its aims but more realistic in its likely results than the proposal put forth by Timberlake. Thus, Hazlitt does not propose the immediate abolition of the Federal Reserve system or the return of the government gold hoard to private hands. Instead, recognizing that a private gold standard would not emerge immediately and automatically alongside the well entrenched fiat-dollar standard, Hazlitt believes that, given the legal framework he has set out, a private, 100 percent gold standard would slowly but surely evolve in step with the inevitable inflationary destruction of the fiat dollar. According to Hazlitt:

> As the rate of inflation increased, or became more uncertain, Americans would tend increasingly to make long-term contracts payable in gold. This is because sellers and lenders would become increasingly reluctant to make long-term contracts payable in paper dollars or in irredeemable money-units of any other kind.
>
> This preference for making long-term contracts in gold would apply particularly to international contracts. The buyer or debtor would then either have to keep a certain amount of gold in reserve, or make a forward contract

> to buy gold, or depend on buying gold in the open spot market with his paper money on the date that his contract fell due. In time, if inflation continued, even current transactions would increasingly be made in gold.
>
> Thus, there would grow up, side by side with fiat paper money, a private domestic and international gold standard. Each country that permitted this would then be on a dual monetary system, with a daily changing market relation between the two monies. And there would be a private gold system ready to take over completely on the very day that the government's paper money became absolutely worthless -- as it did in Germany in November, 1923, and in scores of other countries at various times.[56]

As described by Hazlitt, the process of transition to a private gold standard amidst the hyperinflationary breakdown of the fiat currency is certainly realistic enough. Moreover, it must be admitted that the economy would suffer much less devastation from the consequences of hyperinflation if, upon the demise of the primary fiat-money standard, people did not have to resort to barter but were able to take advantage of an already developing commodity-money standard. Still, Hazlitt's plan leaves one naturally wondering why meaningful monetary reform must await the catastrophe of a hyperinflation, while the economy continues in the throes of an ever worsening stagflation.

In fact, Hazlitt himself expects that the implementation of his proposal will serve to avert a hyperinflationary Armageddon by constraining the government to surrender its fiat-money monopoly and restore a genuine gold standard. Unfortunately, Hazlitt is not very clear on exactly how this would come to pass. He writes:

> I should perhaps make one point clear. I do not expect that allowing citizens to do business in the currencies of foreign nations or in private gold coins will in the long run in most countries mean that these citizens will do most of their business in these foreign or private currencies. I am assuming that practically all governments will continue to issue an official currency and that, when they have ceased inflating, they will issue their own gold coins and certificates. And I assume that most of their citizens will then use their own govern-

> ments' money and coins. But this is because I expect that once freedom of choice in currencies is permitted, each government will begin to reform its own monetary practices. What will count is not only the actual competition of foreign money or private coins, but the ever-present possibility of the competition of foreign or private money.[57]

In this passage, Hazlitt alludes to the potential competition from a private gold standard as the key factor which will induce government to abandon its inflationary ways and embrace the gold standard. However, this contradicts his earlier analysis of the transition from a hyperinflated fiat money to a free-market gold money. As Hazlitt points out, it is only after hyperinflation is well under way that the public will even contemplate incurring the substantial costs of completely abandoning the existing medium of exchange in current transactions as well as credit transactions. In short, inflation will have to progress a long way before the parallel gold standard, as conceived in Hazlitt's plan, presents serious competition to the government fiat money. In the meanwhile, the economy will still be left to suffer the ravages of a hyperinflation.

Conclusion

The road to long-term monetary stability leads ultimately to the complete abolition of the government monopoly of issuing money and, concomitantly, to the return of the function of supplying money to the free market. The most crucial and difficult step along this road -- though certainly neither the first nor the last -- involves reconstituting the dollar, the existing fiat money, as a commodity money. This would be done by restoring it to its original status as a legally redeemable claim to a fixed weight of the former money-commodity, gold. Only if and when this step is taken is there hope of ever achieving the ultimate aim of a wholly "denationalized" money whose supply and value are at long last free from the arbitrary manipulations of a nonmarket monopolist.

FOOTNOTES

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[7] U.S. Congress, Joint Economic Committee, The Gold Standard: Its History and Record Against Inflation, by Roy W. Jastram, with an Appendix on "Restoring the Gold Certificate Reserve," by Robert E.

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[8] Weintraub, "Restoring the Gold Certificate Reserve," p. 21.

[9] Ibid,. p. 22.

[10] Ibid.

[11] Ibid., p. 24.

[12] Quoted in Clark.

[13] Arthur Laffer, Reinstatement of the Dollar: The Blueprint (Rolling Hill Estates, Cal.: A. B. Laffer Associates, 1980). Also see Arthur B. Laffer and Charles W. Kadlec, "The Point of Linking the Dollar to Gold," Wall Street Journal, October 13, 1982, p. 32.

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[15] Jude Wanniski, The Way the World Works (New York: Simon and Schuster, 1978), especially pp. 161-67. See Wanniski, "A Job Only Gold Can Do," New York Times, August 27, 1981, p. A31.

[16] The text of Helms' bill is reproduced in Ernest P. Welker, Plans to Revive the Gold Standard, Economic Education Bulletin, vol. 20, no. 10 (Great Barrington, Mass.: American Institute for Economic Research, 1980), pp. 7-9.

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[19] Ibid., p. 5.

[20] Arthur B. Laffer and Marc A. Miles, International Economics in an Integrated World (Glenview, Ill.: Scott Foresman and Co., 1982), pp. 399-400.

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[31] Lehrman, "Should We (and Could We) Return to the Gold Standard?"

[32] Lehrman, Monetary Policy, the Federal Reserve System, and Gold, p. 41.

[33] Ibid.

[34] Lehrman, *The Case for the Gold Standard*, p. 20.

[35] Ibid., p. 6.

[36] Ibid.

[37] Ibid., pp. 8,10,17,18.

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[43] Ibid., pp. 9-10.

[44] Henry Hazlitt, "The Search for an Ideal Money," *The Freeman* 25 (November 1975): 660-72; Hazlitt, *The Inflation Crisis, and How to Resolve it* (New Rochelle, N.Y.: Arlington House Pub., 1978).

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[46] Ibid.

[47] Ibid.

[48] Ibid.

[49] Ibid., p. 10.

[50] Ibid.

[51] Ibid.

[52] Ibid.

[53] Hazlitt, The Inflation Crisis, p. 176.

[54] Ibid.

[55] Ibid., pp. 187-88.

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[57] Ibid., pp. 189-90.

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