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TAX POLICY—EFFECTIVE FISCAL CONTROL FOR FULL EMPLOYMENT WITHOUT INFLATION: STATE AND LOCAL TAX MEASURES
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Specifically, the Finance Committee raised less than $2.0 billion in "tax expenditure" legislation and reconciled its action with the budget resolution targets by recommending less than a full year's extension of the anti-recession tax cuts.

During the Senate debate on the tax bill, a threshold question was raised concerning the budget resolution. Did the Finance Committee violate the letter or spirit of the budget resolution or the Budget Control Act by utilizing a different means to reach the overall revenue target? Or, was the Finance Committee only "required" by the Budget Control Act to satisfy the "bottom line" of the budget resolution? The debate on this issue was protracted and involved, I suggest, more than a dispute over committee jurisdiction. Whatever one perceives to be outcome of that debate with respect to the immediate issue there involved, it did clearly indicate that the Budget Control Act will, in the future, affect both the spending and taxing side of the budget equation.

As we view the future context in which issues of tax policy will be resolved by the Congress, we may anticipate that the tax writing committees will continue to be faced not only with a binding mandate to raise (or perhaps to "lose" when compared to prior years) a certain amount of revenue within a given fiscal year, but also with "suggestions" from another committee with respect to the mix of provisions deemed desirable to meet the overall revenue target. In this limited sense, the making of tax policy in the first instance may well be regarded by some observers and participants as no longer within the *exclusive* province of the House Ways and Means Committee and the Senate Finance Committee. Whether this development is a salutary one, only time will tell. The budget process is relatively new and some strains will necessarily be felt as its proper role in the overall legislative process develops. One can, at this point, only first suggest that the budget process has to date had a significant impact and second express the hope that it offers a realistic opportunity for effective fiscal control.

In concluding this comment, I would like to return briefly to a question I posed at the outset; namely, what should we ask of our tax system? Whether through the new budget process or otherwise, we do need to focus on directly this question. If we assign to our tax system a broad role in terms of social and economic policy, as we have increasingly done in the recent past, we must consider whether we are asking too much if we also demand that the system be totally equitable, both on a horizontal and vertical basis, that it be neutral, and that it be simple. For example, if our tax system is utilized as a social and economic tool, can it also be neutral? In some instances, it may prove impossible to achieve both goals simultaneously.

Similarly, while most would agree that our tax system can and must be simplified, we must ask whether simplification should be our paramount objective to the exclusion of all others. Many of us could no doubt design a vastly simplified tax system, but some would find that system greatly deficient in terms of equity. For example, should two families earning equal amounts of income be taxed the same even if one of the two suffers a catastrophic illness? Similarly, should we, in the name simplification, eliminate the existing incentives for charitable giving, for providing adequate day care facilities, and so on? At some point, does not total simplification present a possible conflict with the oft-stated goal of equity and the desire to use our tax system to promote economic and social goals?

As we face the prospect of "tax reform" continuing to emerge as a major public policy issue, we must, I suggest, focus not only upon the legislative process, but also upon what we should expect of our tax system. Until we are able to respond effectively, and with a degree of consensus, to that question, we will lack any meaningful basis for review and analysis of the many "tax reform" proposals that will be advanced in the coming months.

TAX POLICY—EFFECTIVE FISCAL CONTROL FOR FULL EMPLOYMENT WITHOUT INFLATION: STATE AND LOCAL TAX MEASURES

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I. INTRODUCTION

For many years I have played the role of a spectator and observer both of the fortunes of our economy and what many economists have had to say about it, particularly with respect

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to the critical problems of unemployment and inflation. In agreeing to address myself to these problems I have finally succumbed to the temptation of entering into the fray. There are many causes of price inflation and unemployment and it is not my intention here to inquiry into all or even most of them. Rather I wish to discuss what I perceive as the primary causes of what appears to be a persistent (endemic) price inflation and moderately high unemployment. Price inflation and/or unacceptably high unemployment have been endemic in our economic system at least since the 1930's. However, the 1951 to 1965 period is illustrative of the "necessity" of a 4.9 percent average unemployment rate in order to hold down the compounded annual rate of increase in the consumer price index to 1.4 percent (See Table I).

In 1965 the problem of price inflation became serious when President Johnson and Congress both accelerated the war in Vietnam and expanded social programs with insufficient tax revenues. This inflation might well have been avoided if the Federal Government had not fooled itself into believing that both "guns and butter" could be financed with an increase in the supply of money to meet Federal budgetary deficits.

After President Nixon took office in 1969, cost-push inflationary forces joined demand-pull forces to create a wage-price spiral. The weather "conspired" to cause a world shortage of food that created an unusual demand for American grain and an extra boost in food prices. In addition the Arab oil exporting countries established an oil embargo and oil prices were drastically increased when the oil embargo was lifted. With a larger share of national income (about $15 to $20 billions) spent on oil, the aggregate demand for other goods fell causing general unemployment to rise. (See George L. Perry) A third cause for higher prices was the devaluation of the dollar (1971-73) which increased prices of imports and increased the demand for American goods. For all these reasons both prices and unemployment rose simultaneously, forcing the economy into the condition of "stagflation." Price inflation reached double digit heights by 1973-74, reflecting an acute loss in the value of the dollar. Thereafter, in 1975, the increase in prices subsided to a rate of about 7.0 percent while unemployment jumped to an annual average rate of 8.5 percent.

The causes of endemic price inflation and unacceptably high unemployment are different generally from those responsible for the acute symptoms of inflation and unemployment experienced since 1965. Specific remedies that promise help in solving these problems are also different, which is not unexpected. However, what is more important is that the causes are often such that they are beyond the control of federal, state and local governments all of which makes the prescription of suitable and timely remedies difficult if not impossible.

Undoubtedly, a higher degree of economic and political responsibility can contribute materially to the goals of full employment and price stability. Fiscal policy can play a significant role in achieving these objectives. Government at all levels, including state and local governments, can play a significant role particularly in treating endemic inflation and unemployment although the federal government must assume primary responsibility for treating acute inflation and unemployment.

Since 1933 persistent and reoccurring unemployment has produced pressure for increased federal spending which has resulted in higher taxes, deficits, and prices. Government intervention has grown to the point where the public sector now equals 35% of GNP and 40% of National Income.

TABLE I*

PRICE MOVEMENTS AND UNEMPLOYMENT RATES, DURING 1951-1976, AND SUBPERIODS

Time Period	Consumer Price Index, Compounded annual Rates of Change	Average Unemployment Rate
1951-65	1.4	4.9
1965-69	3.8	3.7
1969-72	4.7	5.4
1972-73	6.0	4.9
1973-74	10.4	5.6
1975	7.0	8.5
1965-74	5.0	4.6

*Source: See William Fellner for date up to 1975, and the *Economic Report of the President, 1976* for 1975 data.

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Yet, despite the enormous increase in the role of the public sector in our economy today unemployment is worse than at any time since the Great Depression and inflationary pressures in the past few years have been greater than any time since World War II. Of course, much of this growth was for other purposes (such as the development of the Great Society programs) than only that of countering persistently high unemployment.

Persistently high unemployment accompanied with even moderate inflation stems from the fact our economic system of today, or even yesterday, cannot maintain general equilibrium without appropriate adjustments in the real income of factors of production so as to motivate their full employment. Prices as well as wages, rents, interest and profits are not sufficiently flexible and willing to decline promptly and far enough so as "to clear the market." Incentive to invest and the willingness to work for lower real wages are lacking.

It is at this point that command by government steps in because voluntary investment, employment and consumption has been insufficient. Government expenditures in accordance with its preferences (rather than that of private consumers and producers) replace private expenditures "that might have been." National income rises along with consumption, profits, investment and prices. Increased productivity to accommodate higher consumption and private investment will increase employment at prevailing money wage rates. Thus full employment is achieved by command of government because labor prefers to receive a decline in real wages by means of inflation rather than by accepting lower money wages in combination with price stability.

According to Keynesian monetary and fiscal demand-management policies, high unemployment should be fought with some combination of an increase in the total money supply, a tax reduction, or an increase in government spending with an "appropriate" deficit. This increase in aggregate demand with moderate price increases will supposedly create profit opportunities and incentives for business to borrow at prevailing or lower rates of interest.[1] However, this demand-management policy by government assumes that inflation is not, nor will become, a serious problem.

Economic experience during the 1970's showed that demand-management policies are not successful when inflation is substantial as well as continual. With this kind of inflation lenders will boost interest rates as they seek to maintain intact the purchasing power of the funds that they are willing to lend. Thus, inflationary expectations induced by commodity shortages or overly expansionary monetary and fiscal policies will make interest rates rise. High interest rates will reduce profit expectations (reflected in the fall of stock prices) and investment incentives.

We have learned from recent economic events that monetary and fiscal policies for managing aggregate demand are inadequate to the task of reducing excessive unemployment without more inflation. The ready prescription of monetary and fiscal policies for these economic ailments is somewhat analagous to the ready prescription of antibiotics for every infection. Each succeeding infection requires a larger dosage to effect a cure. Yet there are some infections that do not respond to antibiotics. More specific remedies are needed. Similarly, more specific remedies are needed to deal with the energy crisis, the world food shortage, and irresponsible government spending and financing which have been largely responsible for the recent acute siege of inflation and unemployment. Specific remedies are also needed to treat persistent or endemic large-scale unemployment which directly or indirectly share responsibility for a good part of our inflationary pressures. Supply management policies that will increase economic incentives for investment and work are the specific remedies for endemic, and often acute, unemployment and inflation.

While demand management policies are effective under a wide variety of economic conditions, their ineffectiveness under the conditions prevailing in recent years indicates that we have relied excessively on them. Moreover, our concern should be not only with the effectiveness of policies, but also with equity. Now, according to modern macro-economic theory, the major purpose of monetary and fiscal policies for demand management is to reduce real wages, thereby increasing profit expectations, production, investment and employment (See William Fellner, p. 37).[2] It would seem that any policy designed to increase profit expectations by reducing real wages is questionable. It would be far more equitable to increase expectations in higher real income for investors and workers by reducing the real income of unnecessary and undeserving non-producers. This will necessitate turning our efforts to supply management policies even though they deal with problems that have generally been regarded as intractable, at least in the short run. Let us examine the

[1]The lower interest rates are normally expected to occur with government induced increases in the supply of money.

[2]i.e., unless it can be demonstrated that aggregate wages, or at least a substantial portion of them, are receiving a larger share than what is equitable (a producers' surplus or economic rent).

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proposition that endemic and acute deficiencies in aggregate supply are responsible for increasing rates of "normal" unemployment as well as occasional increases that exceed "normal" levels.

II. A Theory of Aggregate Supply

We can agree that in order to stimulate employment it is necessary to provide business with higher profit expectations. But that is not enough. We need to increase incentives among the unemployed to want to work. Inadequate incentives for the voluntary application of both capital and labor in greater measure has led to a sluggish rate of economic growth of only 4 per cent per year. Too much of our real income has gone to non-producers.

In a system of private enterprise, the immediate goal of supply management policies for increasing employment and reducing inflation is that of providing adequate incentives and opportunities for individuals and businesses so that they will voluntarily decide to increase production by working, saving and investing. This implies that excessive unemployment and inflation are the result of practices, institutions, attitudes and values that have weakened work and investment incentives. Conversely, it implies that changes in these institutions, practices, attitudes and values are necessary in order to strengthen work and investment incentives. This approach to the goal of full employment contrasts with demand management policies which "accept" the weakened condition of incentives and hope, none-the-less, to revive real investment incentives and job opportunities by means of inflation.

Institutions, practices, attitudes and values that reduce economic incentive and opportunity for individuals have received a great deal of attention historically and still do today. However, concern over these factors yesterday and today is not based upon, nor related to their (macro-economic) significance with respect to employment and the general price level. Yet these factors are as important to the economy as a whole as they are to its parts.

Economic incentive to invest and work, and thereby increase employment and production (which in turn would keep prices from rising as much) is at a maximum when all of the national income is channeled into the hands of those who contribute to production. This does not preclude a public sector whose activities are supported by the vast majority of producers (see Knut Wicksell). Unfortunately, the system of private enterprise in the United States has suffered an erosion of those very incentives upon which its well-being depend. This erosion is both endemic and to some extent acute as it tends to fluctuate with, and facilitate, short term changes in the economy.

The rivulets of erosion of economic incentive are countless. However, it seems that most of the real national income which is drained off to non-productive individuals can be grouped into the following categories: 1. the economic rent of land, 2. monopoly and the restraining of competition, 3. waste and inefficiency, 4. crime, and 5. transfer payments. These conditions drain the productive vitality of the private enterprise system since they cause a large portion of the real national income to be siphoned off from the potential real wages of workers and potential real profits of investors in capital.[3] Each of these drains is a blight on the economy and, in one way or another, increases costs of production, reduces profits and wages, discourages investment and the desire to work, decreases productivity and increases unemployment and inflation.

While these income drains can more fully account for the endemic unemployment and inflation of our system of private enterprise, they are also at least partially responsible for the acute symptions of these economic ailments. There seems to be ample evidence that the economic rents and values of land, monopoly profits, waste, inefficiency and crime increase at faster rates than the gross national product during periods of relatively full employment and prosperity. These rapidly rising drains on investment and worker income tend to dry up investment and work incentives to the point where total employment increases very little or not at all, and the rate of unemployment may rise.[4]

The major purpose of this paper is to establish the nature of these non-productive drains on national income and their macro-economic significance. Thus, it is desirable to take a closer look at each of these income drains.

The Economic Rent or Price of Land

The drain of the economic rent of land is the most pervasive income drain of all. Since land and its services are supplied by nature, the economic rent of land constitutes a surplus payment

[3] Capital is here defined in the traditional economic sense to mean man-made goods intended for further production, thus excluding land and other natural resources.

[4] If the work force itself increases as it has during the 1970's, it is possible for both total employment and the rate of unemployment to rise simultaneously.

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for production and therefore one variety of non-productive income. Because all economic activity requires the use of land as space and other resources as well, the drain imposed by land rents for leasing or land values for purchase is not only inevitable, but enormous, ranging all the way from choice urban land sites to oil lands.

The barriers which this income drain imposes on investment opportunities are largely hidden in debt instruments of vast magnitude and high or prohibitive fixed interest charges. As an example, a young farmer may have to pay $250,000 for 360 acres of tillable wheat land that can net him an economic rent of $25,000 per annum. The purchase price would reflect the capitalized value of the economic rent at a rate of 10 per cent. Now, our young farmer must pay a 10 per cent rate of interest on the $250,000 mortgage loan that he takes out to buy the farm land. The net economic rent of land is in this manner converted into a fixed interest obligation.

Thus, higher economic rents of land (not of taxes on the land) caused by general inflation or scarcities of land resources, such as oil, are capitalized into higher market prices and the acquisition of these resources for use will require a larger volume of borrowing and fixed interest charges. Thus, the marginal efficiency of investment is reduced as the returns to owners of natural resources increase (absolutely and relatively) and are capitalized into higher values. Dollar investments must constantly rise in order to have the same employment effect. Simply maintaining dollar investments will lead to increasing unemployment. In this sense, high speculative land values lower profitable investment opportunities, and lead to unemployment (See Henry George, p. 263-281).

If land ownership were distributed according to the ownership of capital and if such ownership reflected entrepreneurship, at least approximately, the drain would coincide with the productive contributions of the investor-capitalist. However, the business investor is often neither the owner of land nor capital (real or money) and therefore finds himself exceedingly vulnerable to a fall in gross income. A small decline in gross income may turn the marginal efficiency of investment to negative values and jeopardize the business enterprise and the employment opportunities which it affords. Thus, as the economic rents and prices of land rise to new heights during prosperity and inflation, the marginal efficiency of capital falls and investment and employment opportunities fall along with it.

Monopoly and Restraining Competition

While the practices of monopoly and restraining competition have been viewed traditionally as problems of equity, the theory of aggregate supply views them primarily as problems of the inefficient allocation of real income and resources which cause the underemployment of labor. Thus, many businesses that dominate their markets, including inadequately regulated public utilities, set their prices and output at levels that maximize their profits, if they are aware of their market potentials. On the other hand, if they were faced with competition or adequate regulation, output and employment opportunities would be increased. Similarly, as the bargaining power of labor or minimum wage legislation causes the cost of labor to rise, business must usually either cut back output and employment to maximize profits (or minimize losses) or substitute capital for labor.

The macro-economic significance of the practice of monopoly and the restraining of competition is already recognized to some extent inasmuch as they are often cited as the causes of cost-push inflation. Thus, "administering prices" by some business organizations and "collective bargaining" by powerful labor organizations result in price and wage increases that often exceed the annual rate of growth in national productivity. These practices are essentially conducive to greater unemployment, whereas competition and downward flexibility or stability of prices and wages are compatible with full employment.

The problem of inefficient allocation of resources and large scale unemployment is influenced by practices that restrain competition other than those directly affecting prices and wages. These practices are too numerous to list with reasonable completeness, however a few might be mentioned to suggest their scope. Business collusion for various purposes such as dividing markets, allocating products, limiting production, buying up and sitting on patents, and bribery. These merely reveal the tip of an iceberg of what business can do to restrain competition. Even in the absence of monopoly many industries are dominated by just a few firms which find ways to cooperate for their mutual advantage against the small independents in each industry.

Occasionally, the bargaining power of labor organizations is too great for either public or private employers to oppose. This may well be why the wages of some workers, such as those in steel, auto manufacturing, trucking, and sanitation are surprisingly high and constitute compensation that may be in excess of what is necessary to fill these jobs. Moreover, labor organizations, especially those involving some skill and training, not only limit membership but also *require* membership of a worker before he is given the opportunity to work for business or government. Labor organizations

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also establish arbitrary work rules that affect the rate of production and often the quality of the product (which may be higher or lower than what the market demands).

Many professional associations clearly engage in restrictive practices. These organizations determine who will be admitted and how many. Men and women who are either fully qualified or who can easily become fully qualified and who wish very much to engage in a certain craft or practice a profession at prevailing or even lower monetary compensation are arbitrarily restricted from the opportunity to qualify for entering the craft or profession. Thus, these practices increase the real income of members of certain labor organizations and professions and are responsible for the unemployment of those denied entrance to them. Moreover, the aggregate supply of goods and services produced by restricting employment is less than if employment were not so restricted.

The role of government in creating and supporting monopoly and in reducing competition is well known. The controls over entry into the transportation industry and fares is a good illustration of excessive interference. When a little regulation is good, it is not justified to conclude that a lot of regulation is better. A greater degree of competition in trucking, airlines passenger service, and even in railroads may be highly desirable from the viewpoint of the consumer and pose no threat to the industry as a whole, yet many transportation firms fear to face greater competition.

The government may itself provide direct services as a monopoly such as the U.S. Postal Service. Or in a given community there may be little or no alternative to the local public school system. Such government monopolies tend to lead to a mediocre quality of service as well as to inefficiency, waste and high costs in providing the service.

Government at all levels exert a pervasive influence on wages, prices, and interest rates. This range from minimum wage laws, wages and salaries paid to government workers in comparable jobs with the private sector, the size of the government debt as well as debt management policies, and includes even direct rent controls in New York City. These serve as guidelines or minimums for the private sector and affect either directly or indirectly the taxes and costs of production in the private sector. As these costs are racheted upward the marginal efficiency of capital falls, and with it investment and employment opportunities decline.

Waste and Inefficiency

Waste and inefficiency constitute a real income drain to labor and capital that is often overlooked. For convenience we can separate and trace this drain in both the private and public sectors of the economy. Waste and inefficiency in the private sector may be due to bigness and the inflexibility that goes with it. On the other hand, there may be a lack of capital or knowledge for cutting down on waste and increasing efficiency. Or perhaps managerial and employee responsibility, competency, and skills may be lacking. Union work rules and government regulations may reduce productivity or force the retention or hiring of less competent and productive workers.

The tax structure can affect the extent of waste and inefficiency in many ways. For example, taxes based on net income single out for taxation those businesses that succeed in producing efficiently, whereas those inefficient businesses that cannot produce a net taxable income are exempted from taxation. Another tax that is enormously inefficient is the real property tax on improvements. This *ad valorem* tax increases the cost of additional investment in improvements, lowers investment in improvements and restricts employment opportunities.

Taxes on employment are particularly conducive to increasing unemployment both in terms of increasing labor costs for the employer as well as in terms of reducing the real income of the worker. The difference between the wages paid by a business firm and the wages received by employees should be regarded as a disincentive "wedge" (See Arthur P. Laffer). The "wedge" includes not only payroll taxes but also fringe benefits and costs of complying with government taxes and regulations since they do not add directly to the productivity of the firm. This growing "wedge" will cause some employers to go out of business while those remaining will hire fewer workers. Moreover, as the "wedge" grows the real wages of employees often shrink and the willingness to work of some will be impaired. All of these effects will decrease productivity generally, lower supplies of goods and increase their prices.

The Full Employment and Balanced Growth Act of 1976 provides for an increase in the tax wedge during recessions and a decrease in the wedge during prosperity. This policy is just the reverse of what is necessary to increase profitable employment during a recession and curb inflation during full employment. In reality, the Act is designed to make the unemployment problem even worse than it is already.

It is a fact that many services rendered by the public sector provide benefits such as lower costs of production and a higher real income equivalent for productive workers and thereby add to incentives for investment and work. While this may not ease the disincentive for investment

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and work in a given firm or industry, it would reduce the "gross wedge" to a smaller "net wedge" in the aggregate.

It is generally agreed that waste and inefficiency in the public sector is in all probability greater than in the private sector because of the lack of profits test, the lack of a continuous market discipline, and the lesser concern that goes with managing or working in an enterprise that one does not own. Consequently, employment objectives and rules, as well as productivity standards and rules are frequently at great odds with goals and procedures consistent with productive efficiency and conservation rather than waste, particularly in the amount of labor required to achieve certain tasks.

It is exceedingly difficult, and often impossible to succeed in having voters reveal their true preferences for certain public services and projects. The election of government representatives and administrators all too often is not an expression of the preferences of the electorate, especially when candidates are vague and inconsistent in making their position known on various expenditure matters. Furthermore, once elected, public officials do not always make a sincere and reasonable effort to sense the dominant and changing preferences of their constituents.

It is reasonable to believe that a sizeable gap exists between public projects and services that are actually provided and the projects and services that voters really prefer. Furthermore, it seems reasonable to believe that the public projects and services actually provided are substantially in excess of what could be agreed upon by a majority of informed voters if they had the opportunity to express themselves directly.

Many government projects are approved by clever subterfuge and misinformation or inadequate information. For example, the initial phase of a project is funded frequently without voters or legislators having any estimates of the total cost of the project when fully completed at a future date. Another approach for wasteful expenditures is for departments to make self-serving benefit-cost studies to justify certain projects of limited value. What is needed is an evaluation by competent and disinterested outside (of government) analysts.

The Costs of Crime

Somehow the costs of crime are disregarded as having macroeconomic significance. Yet, the real income drains that these costs place on productive capital and labor exceed those of national defense, according to estimates of the Joint Economic Committee (See *The New York Times*, Jan 2, 1977).* Undoubtedly, many legitimate businesses succumb to the increased cost, taxes, losses, wastes, and inefficiencies due to all sorts of crime. White collar crime alone is estimated to cause losses ($44 billions in 1976) twice as great as what is spent on the entire criminal justice system which includes police protection, criminal courts, and penal institutions.

The cost of narcotics and other dangerous drugs is approximately equal to that of the criminal justice system whereas violent crimes (including murder) and crimes against property cost about one-half as much. However, when we examine the nature of certain "victimless crimes" such as illegal gambling and prostitution, we find that a great deal of disagreement exists as to their net cost. The same is true of illegal immigration.

Transfer Payments and Subsidies

Transfer payments such as unemployment compensation, welfare payments, food stamps, rent subsidies, etc. further serve to solidify the floor to money-wage fixing by contract or law. There is little incentive for many to accept employment at a wage lower than available transfer payments. Moreover, higher public benefits for non-work increases the length of time that recipients remain unemployed. The incentive and success in finding work by unemployed persons is inversely related to the level of welfare and jobless benefits. For example, Texas families remain on welfare for an average (median) of 11 months compared with 34 months in New York where benefits are three times larger. (See June Kronholz)

I am not suggesting that all transfer payments and other government activities of little or no productive value be put to an end. Humane and equity considerations will require substantial expenditures. However, a method of income maintenance must be devised that does not destroy incentives to work.

Not only do transfer payments, subsidies, and consumer-type public services affect the willingness of unemployed labor to take work, it also affects the willingness of workers to continue their

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employment because payroll taxes for social security payments are levied on any amount of earnings up to $16,500 for 1977. These taxes constitute real income drains on all taxpaying workers and owners of capital who employ those workers.

We cannot leave this subject without mentioning that large real income drains on productive labor and capital arise out of well-meaning government subsidies which are capitalized into higher land values. For example, government payments to farmers for producing and not producing certain crops does not help the farm operator or new farmers as much as the previous owners of farmland when the subsidies were begun. An inevitable result of this practice has been to increase the values (and economic rents) of farmland dramatically (See Boxley and Anderson). The value of farmland has increased to the point where today farm ownership for the new generation of farmers is virtually prohibitive, and farm subsidies share a large part of the responsibility for that critical problem. Moreover, there is good reason to believe that much of the benefit of government expenditures on expressways, urban renewal, and medicaid, to name but a few, goes to landowners rather than investors in capital or labor (or professional service).

III. Supply Management Policies

The brief preceding sketch of a theory of aggregate supply implies that supply management policies should have the goal of increasing the real income of producers in the private sector in order to realize higher investment and employment targets. Furthermore, the real income of capital and labor should be achieved by redistributing a portion of the numerous income drains in favor of capital investors and workers without increasing fiscal deficits and monetary expansion, the tools of aggregate demand management.

Tax policies in supply management should establish as a first priority the taxing of the producers' surplus of land, labor, and capital. Implementing this goal will require a skillful design. It is not sufficient for total tax burdens to be less than total producers' surplus. Incentives can be impaired if some portions of the supply of labor and capital are taxed in excess of their producers' surplus while other portions of labor and capital are taxed at less than their producers' surplus. If labor and capital are sufficiently mobile these disparities may be overcome in time, otherwise they will persist with the consequences of lower real incomes in the "overtaxed" areas and industries, as well as lower investment, employment and output.

Expenditure policies in supply management should limit non-productive public services, i.e., consumer-type services and transfer payments, to the producers' surplus that is taxed. Public expenditures for productive public services may justify taxing the real income of capital and labor beyond their producers' surplus since such expenditures, if well conceived, increase efficiency, lower production costs, increase total output, and thus increase real wages or the marginal efficiency of capital in real terms.

Since the Great Depression (of the 1930's) and the simultaneous birth of Keynsian economic theories the nation has been conditioned into the belief that only the federal government is capable of coping with the problem of mass unemployment because the expenditures required to raise aggregate demand require fiscal and monetary resources that only the federal government can command. Thus, the very nature and scale of operation required by demand management policies are such that state and local governments are regarded as impotent bystanders, and citizens feel persuaded, although somewhat reluctantly, to support a highly centralized and powerful federal government.

Now the above-described theory of aggregate supply should give encouragement to those who have lamented over the helplessness of state and local government as well as those who have viewed with grave concern the awesome power that has been assumed by the federal government and the consequences of many of its actions. As a matter of fact, state and local governments can perform a major role in supply management policies inasmuch as many of these policies fall within their constitutional authority. Moreover, many effective supply management measures can be taken by these governments that also lie within their financial capacities. Indeed, if properly conceived, supply management policies should place a lesser strain upon the financial capacity of our economy as well as on all levels of government.

It may come as a shock for many to realize that state and local governments can assume an important role in macro-economic policy, and that they are in a key position for initiating a wide variety of policies with the purpose of reducing non-productive income drains and thereby increasing the real income of labor and capital. The seriousness and magnitude of real income drains vary among cities and states. Each knows best which combination of drains threaten its economic vitality the most. Once these are identified, each city and state can devise its own multipronged attack against those drains.

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A comprehensive program designed to reduce non-productive real income drains will require far more than measures in public finance alone. For example, state and local governments can take measures for facilitating the entry of labor and business into existing markets, greater freedom and flexibility in wage and price competition, and the repeal of minimum wage laws. The cost of crime can be cut by enacting more effective laws, establishing administrative practices and securing community involvement for crime prevention. Other measure might include the establishing of narcotic clinics to reduce narcotic related crimes. Perhaps some "victimless" crimes should be decriminalized. The reduction of delays in the criminal justice process, greater certainty and uniformity in penalties for similar offenses, and greater judicial restraint in turning habitual criminals back on society . . . all these as well as other measures may help cut the enormous costs of crime which reduce the real income of labor and capital both directly and in terms of higher taxes as well as in increased unemployment.

A reduction in non-productive real income drains requires that total expenditures be limited so as to minimize the taxation of the non-surplus income of labor and capital, unless the productive benefits of certain expenditures exceed such taxes. This will necessitate a careful review of state and local budgets to reduce waste in capital and operating outlays. Public service and capital expenditures should be made only after careful study and with the support of a clear and strong majority of the electorate. Continual and serious efforts must be made in improving administrative efficiency and eliminating waste.

Tax measures require that top priority be given to reforming the property tax so as to reduce or exempt the *ad valorem* tax on capital, i.e., improvements and personalty, and increase the tax on land values, which reflect the drain of economic rent by previous or present land owners (see Arthur P. Becker). In addition, as many public services as possible, such as sewer and water, should be financed by service charges rather than taxes (See Werner Z. Hirsch). If the services are essential, low income families can be assisted with transfer payments. Property tax reform and greater reliance on service charges certainly are not new. However, their significance as important specific measures for increasing investment, employment and productivity can be accepted with confidence and urgency.

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