A Dubious Maneuver in the Three-Front War

While there was plenty to find fault with in President Ford's economic proposals, some of the commentary on them indicated serious misconceptions in the minds of the commentators. One is the notion that the current economic mess is largely attributable to mistakes committed last summer and fall by the President, his economic counselors, and the Federal Reserve Board. In truth, the mess was in the making for ten years under Lyndon Johnson and Richard Nixon.

Partly as a result of economic blunders and evasions of responsibility during that span, Ford inherited an economy afflicted with (among other things) double-digit inflation, burdensome debt, inadequate profits, overtaxation, extensive transfer of income from people who work to people who don't, deeply eroded consumer morale, widespread pessimism about the future, and the pervasive strains of adjusting to a sudden quadrupling of oil prices.

In the face of all this, to be sure, Ford did not show great skill in either prognosis or prescription, but neither did most of the numerous economists whom he invited to give him the benefit of their wisdom. As for the Fed, it apparently tightened the screws too much during the late summer and the fall, but it did so in a valiant effort to restrain inflation that was running at a pace generally agreed to be intolerable.

Another misconception is the notion that, given enough goodwill, it is possible to devise a program that will rapidly restore the economy to robust health. Anybody who believes this is not yet even at square one.

Don't throw away the gains

Also mistaken is the view that with a recession on, we shouldn't let concern about inflation cramp our efforts to bring the unemployment rate down. This is a disturbing, even dangerous notion. At a painful cost in unemployment and lost production, we have in the last few months gained some ground against inflation. Recession is indeed having the classic effect on prices. Inflation has been decelerating, and here and there prices have actually retreated. To give up prematurely and go for full-sail reflation would be to throw away the gains, and to assure that the people who lost their jobs in recent months have suffered in vain.

What's more, we don't have the option of trading a little more inflation for low unemployment and rapid growth. Inflation has been, and still is, a depressing influence on the economy, impairing consumer morale, eroding real profits, keeping interest rates high.

As President Ford recognized, economic policymaking is now in an unprecedented bind. In his words, "We must wage a simultaneous three-front campaign against recession, inflation, and energy dependence." The requirements pull in different directions. A course of action that seems appropriate on one front may have adverse effects on one or both of the other two fronts.

Bad medicine for slumpflation

The President's own program provides a case in point. While it is desirable to cut petroleum consumption, trying to do that by imposing a levy on crude oil is the wrong approach in the present economic circumstances. It will have pervasive price-jacking effects, raising costs for many manufacturers, utilities, and commercial businesses, as well as for motorists, homeowners, and transportation companies. The combined, cumulative impact on consumer prices might amount to several times the revenues from the new levy.

So even if the revenues are returned to the private economy, the President's petroleum impost may result in a serious pinch on real personal income. And uncertainties about the effects of the measure will impose an additional inhibition on business investment. Thus an impost on crude oil will be both inflationary and depressant—bad medicine indeed for slumpflation.

What's more, it is far from clear that, aside from gasoline, a levy on crude will reduce consumption of petroleum very much in the short run. There are pretty tight limits to how much petroleum can be saved in home heating, manufacturing, and power generation through simple economizing. Significant gains will have to come from more and better insulation, changes in manufacturing processes, and conversions from oil to coal. These alterations take time and entail capital costs.

In the present economic context, a large increase in the federal gasoline tax (20 cents a gallon, say) would be a much better way of curtailing dependence on imports. Effects on other prices would be less pervasive. And there are possibilities for quick and significant reductions in gasoline consumption through car pooling, increased use of public transportation, cutbacks in miles covered on weekend and vacation trips, etc.

We are familiar with arguments against putting heavy reliance on an increase in the gasoline tax. For one thing, gasoline accounts for less than 30 percent of all petroleum consumption in the U.S., so it would take quite a deep cut in the use of gasoline to bring about a substantial reduction in the overall use of petroleum. Moreover, a large increase in the gasoline tax would hit the already battered auto industry, whose troubles are exerting a serious drag on the whole economy.

What is mainly hurting new-car sales, however, is the sad erosion of consumer purchasing power and confidence. If a tax on crude has the predicted effects of fueling inflation and pinching real income, it will worsen the plight of consumers and so work against a recovery in auto sales. An increase in the gasoline tax, on the other hand, would tend to strengthen demand for cars with good fuel economy. It appears, then, that in favoring a tax on crude over a higher tax on gasoline, auto-industry executives may have misjudged where their best interests lie.

The scattergood approach

To avoid depressing effects on demand, revenues from an added tax on gasoline (or a levy on crude) should be recycled into the economy. There is no obviously right way to do this, but it is clear that distributing the revenues to consumers in proportion to the petroleum tax they pay would defeat the purpose of the tax. President Ford's scattergood approach of giving out a bowlful here and a bowlful there in the form of income-tax reductions or cash payments is not so obviously wrong, but it does not seem the best approach either.

David Gordon Wilson, professor of mechanical engineering at M.I.T., has put forward a radically simple idea that at least merits consideration as an alternative approach for any tax to discourage petroleum consumption: distribute the revenues to all adults equally. Professor Wilson himself applies the concept more broadly, but it is applicable to a gasoline tax (or to revenues from a levy on crude oil).

If each adult got an equal share in the distribution of gasoline-tax revenues, the net cost of the tax to each would depend entirely on his or her (or the family unit's) direct and indirect consumption of gasoline. There would be income redistribution from heavy users to light users—which is the kind of redistribution appropriate to the case. The allocation of revenues from a tax designed to cut consumption of petroleum should not get tangled up with questions of social justice.

Regulatory flypaper

Congress will have its say on the President's program, of course, but any changes it makes will not necessarily be for the better. The Democrats hold lopsided control of both houses of Congress, and what congressional Democrats have been saying about economic matters lately is far from reassuring.

For example, the program recently put forward by a special House Democratic study group would entangle the economy in swirls of regulatory flypaper. Proposals include a "credit allocation program" and an "independent" price-overseeing agency with power to impose price controls "on a selective basis." We hope that what the study group produced will not prove to be a portent of things to come, and that when Congress gets around to drafting actual economic legislation, clearer and wiser heads will prevail.